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Report No. D-2011-104

September 8, 2011

# Inspector General

## United States Department of Defense



### Pricing and Escalation Issues Weaken the Effectiveness of the Army Contract With Sikorsky to Support the Corpus Christi Army Depot

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## Acronyms and Abbreviations

AMC	Army Materiel Command
AMCOM	Army Aviation and Missile Life Cycle Management Command
BLS	Bureau of Labor Statistics
CCAD	Corpus Christi Army Depot
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DLA	Defense Logistics Agency
FAR	Federal Acquisition Regulation
GAO	Government Accountability Office
NSN	National Stock Number
OIG	Office of Inspector General
TELSS	Technical, Engineering, and Logistical Services and Supplies





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September 8, 2011

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION,  
TECHNOLOGY, AND LOGISTICS  
DIRECTOR, DEFENSE CONTRACT MANAGEMENT AGENCY  
DIRECTOR, DEFENSE LOGISTICS AGENCY  
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Pricing and Escalation Issues Weaken the Effectiveness of the Army Contract  
With Sikorsky to Support the Corpus Christi Army Depot (Report No. D-2011-104)

We are providing this report for review and comment. We calculated that Sikorsky charged the Army \$11.8 million (51.4 percent) more than fair and reasonable prices for 28 parts. In addition, AMCOM will pay excessive escalation of \$21.0 million over the contract period because contract escalation was not tied to an economic index. This report is one of two reports examining the Army contract with Sikorsky to support Corpus Christi Army Depot. We considered management comments on a draft of this report when preparing the final report.

DOD Directive 7650.3 requires that recommendations be resolved promptly. The comments from the Deputy to the Commanding General, AMCOM were only partially responsive. Therefore, we request additional comments on Recommendations 2.b(1), 2.b(3), 2.b(4), 2.b(7), 2.b(8), and 2.b(9) by October 11, 2011.

If possible, send a .pdf file containing your comments to [audacm@dodig.mil](mailto:audacm@dodig.mil). Copies of your comments must have the actual signature of the authorizing official for your organization. We are unable to accept the /Signed/ symbol in place of the actual signature. If you arrange to send classified comments electronically, you must send them over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Please direct questions to Mr. Henry F. Kleinknecht at (703) 604-9324 (DSN 664-9324) or [REDACTED] at (703) 604-[REDACTED] (DSN 664-[REDACTED]).

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# **Pricing and Escalation Issues Weaken the Effectiveness of the Army Contract With Sikorsky to Support the Corpus Christi Army Depot**

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## **What We Did**

We evaluated the Army Aviation and Missile Life Cycle Management Command (AMCOM) material purchases from Sikorsky Aircraft Corporation (Sikorsky) supporting the Corpus Christi Army Depot (CCAD) to determine whether the partnership agreement effectively minimized the cost of direct materials to the depot. This report addresses spare parts pricing problems. A subsequent report will address other contract concerns.

## **What We Found**

AMCOM officials did not effectively negotiate prices for 28 of 46 noncompetitive spare parts reviewed because neither Sikorsky nor AMCOM officials performed adequate cost or price analyses of proposed subcontractor prices. Sikorsky also paid excessive prices to subcontractors (pass-through costs) and did not always provide the most current, complete, and accurate cost data (defective pricing). In addition, the CCAD/Sikorsky contract established excessive inflation rates that were not tied to an economic index.

We calculated that Sikorsky charged the Army \$11.8 million or 51.4 percent more (\$34.7 million versus \$22.9 million) than fair and reasonable prices for 28 parts. If prices are not corrected, AMCOM officials will pay excessive profits of approximately \$16.6 million over the remaining 2 years of the contract. During the audit, Sikorsky agreed to provide refunds of about \$1.0 million. In addition, AMCOM will pay excessive escalation costs of \$21.0 million because contract escalation was not tied to an economic index.

## **Recommendations, Management Comments, and Our Response**

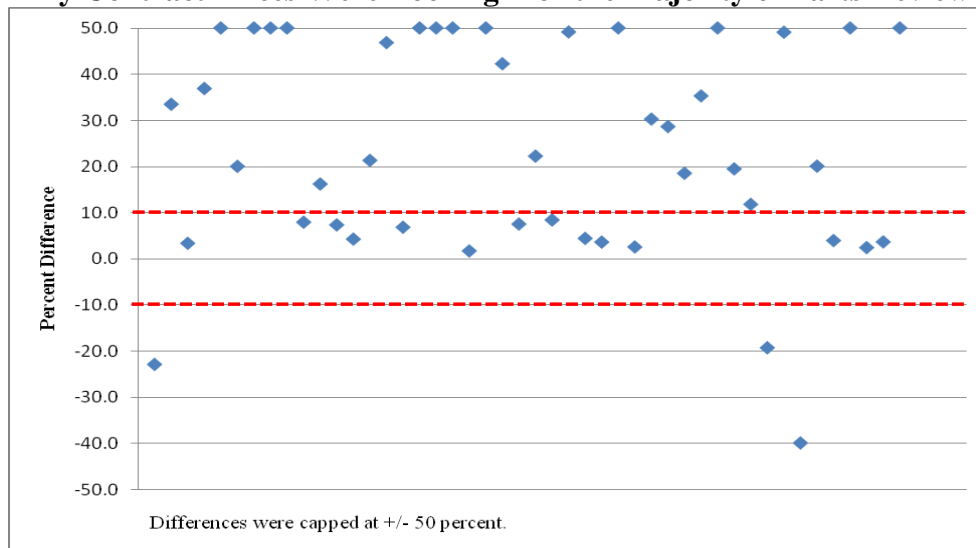
Among other recommendations, AMCOM officials need to correct prices and seek refunds totaling about \$11.0 million for unnecessary subcontractor pass-through costs, an unacceptable quantity curve, and instances where Sikorsky negotiated lower supplier prices after negotiating with the Army. AMCOM officials should procure the remaining contract requirement for a rotor from the Defense Logistics Agency (DLA), to save more than \$1.3 million. AMCOM officials need to develop procedures that require the contracting officers or other oversight officials to perform price analysis in conjunction with cost analysis. Also, AMCOM officials need to take immediate action to correct excessive prices caused by too much escalation and use an appropriate economic index for the contract. The Director, Defense Procurement and Acquisition Policy, needs to issue guidance that emphasizes performing cost analysis of a sample of spare parts before exercising an option under a firm-fixed-price contract.

Overall, management comments were responsive, and management is taking action to address pricing problems. AMCOM is working to obtain items from DLA at lower prices or reduce the current contract price and will conduct cost analysis of a sample of high-risk, high-dollar items before exercising future options. However, some management comments were not fully responsive to the recommendations. Therefore, we request additional comments by October 11, 2011. Please see the recommendations table on page iii.

## Report Highlights

Army contract prices were higher than DoD OIG calculated fair and reasonable prices, and prices for the majority of parts were outside what we considered an acceptable range of plus or minus 10 percent. See the finding for a more detailed discussion of pricing problems identified. The figure below appears on page 37 of the report.

**Army Contract Prices Were Too High for the Majority of Parts Reviewed**



Some specific examples of pricing problems found were for the rotor and flush door ring (reproduced here from pages 15 and 28, respectively). In each case, the contract price was significantly higher than DLA's standard unit price.

**Rotor**



DLA 2011 Standard Unit Price: \$1,536.65  
 Sikorsky 2011 Unit Price: \$7,814.88  
**Excessive Prices:** 2008–2010: \$686,293  
 (Potential) 2011–2012: \$1,344,973

**Flush Door Ring**



DLA 2010 Standard Unit Price: \$8.37  
 Sikorsky 2010 Unit Price: \$284.46  
**Excessive Prices:** 2008–2010: \$195,276  
 (Potential) 2011–2012: \$218,523

## Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Director, Defense Procurement and Acquisition Policy		3
Commander, Army Aviation and Missile Life Cycle Management Command	2.b(1), 2.b(3), 2.b(4), 2.b(7), 2.b(8), 2.b(9)	2.a, 2.b(2), 2.b(5), 2.b(6), 2.b(10)
Director, Defense Contract Management Agency		1

**Please provide comments by October 11, 2011.**



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# Introduction

## Objectives

The overall objective of the audit was to evaluate material purchases made at Corpus Christi Army Depot (CCAD) through the partnership agreement with Sikorsky Aircraft Corporation (Sikorsky). Specifically, we determined whether the partnership agreement<sup>1</sup> with Sikorsky effectively minimized the cost of direct materials to the depot. See Appendix A for a discussion of the scope and methodology and prior coverage. This report is one of two reports examining the Army contract with Sikorsky to support CCAD; the other report will address other CCAD/Sikorsky contract concerns.

We performed this audit pursuant to Public Law 110-417, “Duncan Hunter National Defense Authorization Act for Fiscal Year 2009,” section 852, “Comprehensive Audit of Spare Parts Purchases and Depot Overhaul and Maintenance of Equipment for Operations in Iraq and Afghanistan,” October 14, 2008. Section 852 requires:

... thorough audits to identify potential waste, fraud, and abuse in the performance of the following: (1) Department of Defense contracts, subcontracts, and task and delivery orders for—(A) depot overhaul and maintenance of equipment for the military in Iraq and Afghanistan; and (B) spare parts for military equipment used in Iraq and Afghanistan...

## Background

### ***Corpus Christi Army Depot***

CCAD, located in Corpus Christi, Texas, is a maintenance depot in the Army Working Capital Fund Industrial Operations activity group whose mission is to overhaul, repair, modify, retrofit, test, and modernize helicopters, engines, and components for all services and foreign military customers. CCAD also is actively engaged in resetting equipment returning from operations in Iraq and Afghanistan. CCAD is in the chain of command of the Army Aviation and Missile Life Cycle Management Command (AMCOM).

### ***Army Aviation and Missile Life Cycle Management Command***

AMCOM is headquartered at Redstone Arsenal, Alabama, and is a major subordinate command of the Army Materiel Command (AMC). AMCOM was established as a readiness command to develop, acquire, field, and sustain aviation and missile weapons systems. AMCOM provides life-cycle management of Army aviation and missile systems from research and development to procurement and production; from spare parts availability to flight safety; and from maintenance and overhaul to eventual retirement. In addition, AMCOM strives to ensure that the Army's aviation and missile systems are technologically superior, affordable, and always ready for use.

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<sup>1</sup> The partnership agreement is a contract for technical, engineering, and logistics services support and for material parts support.



## ***Defense Logistics Agency***

The Defense Logistics Agency (DLA), headquartered at Fort Belvoir, Virginia, provides logistics, acquisition, and technical services to the Army, Navy, Air Force, Marine Corps, other Federal agencies, and joint and allied forces. DLA reportedly supplies 84 percent of the military's spare parts. Further, in addition to regional commands, DLA is organized into primary level field activities. Among them are the DLA Land and Maritime, DLA Troop Support, and DLA Aviation.

## ***Sikorsky***

Sikorsky Aircraft Corporation, according to its Web site, is a “world leader in the design, manufacture and service of military and commercial helicopters; fixed-wing aircraft; spare parts and maintenance, repair and overhaul services for helicopters and fixed-wing aircraft; and civil helicopter operations.” One of the helicopters that Sikorsky manufactures is the UH-60 Blackhawk helicopter. The Blackhawk, a utility tactical transport helicopter, entered Army service in 1979. Its mission is to provide air assault, general support, aeromedical evacuation, command and control, and special operations support to combat and stability and support operations. Figure 1 shows the Blackhawk helicopter.

**Figure 1. UH-60 Blackhawk Helicopter**



Source: [www.army.mil](http://www.army.mil)

## ***CCAD/Sikorsky Contracts***

In December 2002, the AMCOM Contracting Center issued a delivery order contract to Sikorsky, which bundled the technical, engineering, and logistical services and supplies (TELSS) support provided to CCAD for the repair, overhaul or recapitalization, and upgrade of the H-60 utility series helicopter. Under TELSS, Sikorsky acts as AMCOM's procurement manager and is responsible for obtaining and providing material needed by CCAD. AMCOM officials view TELSS as a success when repair turn around time of airframes and depot level repairable components are reduced and the overall production quality is improved. The AMCOM Contracting Center has awarded four TELSS contracts to Sikorsky.

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### **Contract DAAH23-03-D-0043**

The AMCOM Contracting Center awarded the initial CCAD/Sikorsky contract on December 2, 2002. The contract was a 5-year fixed-price, indefinite-delivery, indefinite-quantity requirements type contract for integrated services and supplies to support the overhaul and repair of H-60 components at CCAD. The total contract value was \$415 million, or an average of about \$80 million a year.

### **Bridge Contracts (W58RGZ-08-C-0037 and W58RGZ-08-C-0172)**

The AMCOM Contracting Center awarded the initial bridge contract, W58RGZ-08-C-0037, on November 29, 2007, for the period December 1, 2007, through May 30, 2008. The total contract value was \$76 million. The AMCOM Contracting Center awarded the second bridge contract, W58RGZ-08-C-0172, on June 2, 2008, for the period June 2, 2008, through November 30, 2008. The total contract value was about \$101 million. The value of the two contracts together was about \$177 million.

### **Contract W58RGZ-09-D-0029**

The AMCOM Contracting Center awarded the current contract on November 24, 2008. This contract is a firm-fixed-price, indefinite-delivery, indefinite-quantity contract with options available to extend performance through November 30, 2012. The TELSS contract has an annual cost of about \$224 million or \$895 million for the 4-year performance period and includes over 7,000 items.

### ***Nonstatistical Audit Sample of Material***

We selected 332 national stock numbers (NSNs) to review, which equaled about 80 percent of the total dollar value of material Sikorsky was required to furnish for the Blackhawk weapon system from 2009 through 2012. We evaluated current inventory levels and contract prices to determine if they were excessive. From this list of items, we selected 46 items on which to perform cost analysis to determine the reasonableness of contract prices. This report addresses spare parts pricing problems. A subsequent report will address other contract concerns. For consistency, we used the sample numbers from the overall sample of 332 NSNs in both audit reports evaluating the CCAD/Sikorsky contract.

### **Review of Internal Controls**

DoD Instruction 5010.40, "Managers' Internal Control Program (MICP) Procedures," July 29, 2010, requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls. We identified internal control weaknesses for AMCOM. Specifically, AMCOM did not have adequate procedures to ensure that both cost and price analyses were performed to establish the reasonableness of proposed subcontract prices that were used to negotiate contract prices. AMCOM also needs to perform cost analysis and adjust pricing of a limited sample of high-risk, high-dollar items before exercising option years. We will provide a copy of the report to the senior official responsible for internal controls for AMCOM.

## Finding. Spare Parts Pricing Problems

AMCOM officials did not effectively negotiate fair and reasonable prices for noncompetitive spare parts procured on the CCAD/Sikorsky contract. We reviewed costs for 46 high-dollar parts valued at about \$64.4 million and identified pricing problems with 28 of the parts valued at about \$34.7 million. These pricing problems occurred because neither Sikorsky nor AMCOM officials performed adequate cost or price analyses<sup>2</sup> of proposed subcontractor prices that were used to support negotiated prices. The pricing problems also occurred because Sikorsky officials proposed, and AMCOM officials accepted, questionable cost or pricing data that had no relationship to the actual price Sikorsky negotiated with its subcontractors. Specific problems include:

- Sikorsky furnished certified cost or pricing data that were not current, complete, and accurate at the time of the material certification cutoff date (3 parts) and used an unacceptable quantity curve [REDACTED] in determining the cost basis (1 part).
- Sikorsky accepted unreasonable price increases from subcontractors resulting in excessive pass-through costs (5 parts).
- Sikorsky consistently negotiated lower firm prices with suppliers after prices were agreed to with AMCOM and also proposed prices based on significantly lower quantities than it purchased (19 parts).

As a result, we calculated that Sikorsky charged the Army \$11.8 million (51.4 percent) more than fair and reasonable prices (\$34.7 million versus \$22.9 million) for 28 parts through November 2010. If prices are not corrected, AMCOM officials will pay excessive profits of approximately \$16.6 million over the remaining 2 years of the CCAD/Sikorsky contract. During the audit, Sikorsky proposed refunds of about \$1.0 million to address pricing problems. Contract prices for 18 parts (15 higher and 3 lower), valued at \$29.7 million, had minor differences (\$1.3 million less) from cost-based prices of \$31.0 million. In addition, through 2010, we calculated that AMCOM paid \$5.4 million more than necessary due to excessive contract escalation rates that were not tied to an economic index and that AMCOM will pay excessive prices of about \$15.6 million (\$6.9 million in 2011 and \$8.7 million in 2012) over the remaining 2 years of the contract if not corrected.

## Guidance

### ***Subcontract Pricing Considerations***

Federal Acquisition Regulation (FAR) 15.404-3, "Subcontract Pricing Considerations," requires contracting officers to determine price reasonableness for the prime contract,

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<sup>2</sup> The Director, Aviation Logistics, AMCOM Contracting Center, stated that a cost/price group is being developed to assist AMCOM in contract negotiations.



including subcontracting costs. Further, the prime contractor must evaluate subcontract prices to establish price reasonableness as part of the prime contract proposal. Specifically, the FAR states:

- (a) The contracting officer is responsible for the determination of price reasonableness for the prime contract, including subcontracting costs. The contracting officer should consider whether a contractor or subcontractor has an approved purchasing system, **has performed cost or price analysis of proposed subcontractor prices, or has negotiated the subcontract prices before negotiation of the prime contract**, in determining the reasonableness of the prime contract price. **This does not relieve the contracting officer from the responsibility to analyze the contractor's submission, including the subcontractor's cost or pricing data.**
- (b) The **prime contractor** or subcontractor shall –
  - (1) **Conduct appropriate cost or price analyses to establish the reasonableness of proposed subcontract prices;**
  - (2) **Include the results of these analyses in the price proposal;** and
  - (3) When required by paragraph (c) of this subsection, **submit subcontractor cost or pricing data to the Government as part of its own cost or pricing data.**
- (c) Any contractor or subcontractor that is required to submit cost or pricing data also shall obtain and analyze cost or pricing data before awarding any subcontract, purchase order, or modification expected to exceed the cost or pricing data threshold, unless an exception in 15.403-1(b) applies to that action. **[emphasis added]**

### ***Defective Pricing***

FAR 15.407-1, “Defective Cost or Pricing Data,” states that the Government is entitled to a price adjustment, to include profit on items that were based on defective data and any overpayments plus interest. The Government is also entitled to the amount equal to the overpayment as penalties for defective cost or pricing data.

The Defense Procurement and Acquisition Policy, “Contract Pricing Reference Guides,” define defective pricing in the following manner:

Defective pricing is any contracting action subject to the Truth in Negotiations Act (TINA) where the negotiated (other than sealed bidding procedure) contract price including profit or fee was increased by a significant amount because:

- The contractor or a subcontractor at any tier furnished to the Government cost or pricing data that were not complete, accurate, and current as certified in the contractor's Certificate of Current Cost or Pricing Data;
- A subcontractor or a prospective subcontractor at any tier furnished to the contractor cost or pricing data that were not complete, accurate, and current as certified in the contractor's Certificate of Current Cost or Pricing data; or

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- Any of the above parties furnished data of any description that were not accurate.

### ***Audits Have Found That Sikorsky Does Not Perform Adequate Subcontractor Cost or Price Analyses***

Since 2006, the Defense Contract Audit Agency (DCAA) has consistently documented in its reports that Sikorsky does not perform adequate cost or price analyses. Sikorsky also

*Since 2006, DCAA has consistently documented in its reports that Sikorsky does not perform adequate cost or price analyses.*

does not obtain certified cost or pricing data when required by FAR 15.404-3 for proposed subcontractor prices. In DCAA Report 2641-2006C12030001, "Audit of Purchasing System Internal Controls and Related Policies and Procedures," February 15, 2007 (review

conducted in 2006), DCAA concluded that Sikorsky's purchasing system was inadequate in part. The report stated that Sikorsky's purchase order files "...lacked significant supporting documentation." Some of the missing data from the purchase order files included cost or price analysis data.

Further, DCAA audit report on the Defense Advanced Research Projects Agency Sandblaster Program (Report No. 2641-2007C24020001), April 23, 2007, identified multiple estimating system deficiencies. These deficiencies included:

- failure to properly identify subcontracts for which cost analysis is required and provide a schedule for performing cost analysis;
- failure to timely perform cost analysis of proposed subcontracts; and
- failure to use subcontract cost analysis to determine price reasonableness

DCAA cited Sikorsky with the failure to perform cost analysis on two subcontractors that exceeded the \$650,000 (currently \$700,000) cost or pricing threshold. According to the report, **Sikorsky planned "...to perform cost analyses after the negotiation of the prime contract and prior to awarding the subcontracts."** [emphasis added]

In an April 15, 2008, report DCAA again cited Sikorsky's purchasing system as inadequate in part and that purchase order files did not include cost or price analysis documentation (Report No. 2641-2008A27000017).

The October 22, 2007, contractor purchasing system review conducted by the Defense Contract Management Agency (DCMA) did not specifically address whether cost or price analyses of subcontract prices were completed in a timely manner. The January 5, 2011, contractor purchasing system review conducted by DCMA found that price analysis was not effective or was not completed for 30 percent of the dollars reviewed. In addition, the report did not specifically address whether adequate cost or price analysis was completed before negotiations with DoD.

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During this audit, we found that Sikorsky negotiated prices for the CCAD/Sikorsky contract before finalizing prices with its suppliers. Performing cost or price analyses of subcontractor prices after negotiation of contract prices with AMCOM provides no benefit to the Government and allows Sikorsky to maximize its profits by lowering its costs after negotiations with the Government. *The DCMA Contractor Purchasing Review Division Director should identify the purchasing system at Sikorsky Stratford, Connecticut, as high-risk and schedule a purchasing system review to determine whether Sikorsky conducts subcontractor cost or price analyses before prime contract negotiations and whether quantity discounts are being adequately passed on to the Government.* [Recommendation 1]

## Pricing Problems for Sample Parts

To calculate the DoD Office of Inspector General (OIG) price, we used Sikorsky's costs and applied their wrap rate. The wrap rate includes costs of doing business (burdens) such as overhead, general and administrative costs, and profit. Table 1 summarizes the pricing problems by category, based on actual sales through 2010. Each category of pricing problems is discussed in detail following the summary table.

**Table 1. Pricing Problems Exist for 28 of 46 Parts Reviewed (2008–2010)**

Category	No. of Items	Contract Price	OIG Calculated Price	Excessive Profit	
				Amount	Percent
Defective Data and Unacceptable Quantity Curve <sup>1</sup>	4	\$2,021,216	\$523,867	\$1,497,349	285.8
Excessive Subcontractor Prices and Pass-Through Costs	5	20,946,991	13,951,919	6,995,072	50.1
Sikorsky Negotiated Lower Prices With Suppliers	19	11,724,322	8,437,580	3,286,742	39.0
<b>Subtotal – Significant Pricing Issues</b>	<b>28</b>	<b>\$34,692,529</b>	<b>\$22,913,366</b>	<b>\$11,779,163</b>	<b>51.4</b>
Contract Prices Were Slightly Higher Than Costs	15	17,840,783	16,784,651	1,056,132	6.3
Costs Were Higher Than Contract Prices <sup>2</sup>	3	11,841,330	14,184,510	(2,343,179) <sup>3</sup>	(16.5)
<b>Subtotal – Minor Pricing Issues</b>	<b>18</b>	<b>29,682,113</b>	<b>30,969,160<sup>3</sup></b>	<b>(1,287,047)</b>	<b>(4.2)</b>
<b>Total</b>	<b>46</b>	<b>\$64,374,642</b>	<b>\$53,882,526</b>	<b>\$10,492,116</b>	<b>19.5</b>
<sup>1</sup> We used the DLA standard unit price in our calculations of excessive profit for one item because an unacceptable quantity curve [REDACTED] was used to establish the basis of the contract price. <sup>2</sup> The loss shown primarily relates to incorrect pricing of one item based on an expired long-term agreement. <sup>3</sup> Slight rounding inconsistencies exist because auditor calculations included decimal places.					

Table 2 shows the excessive prices for 2011 and 2012 and includes a 4 percent annual escalation factor.

**Table 2. Excessive Prices If Problems Are Not Corrected (2011–2012)**

Category	No. of Items	Contract Price	OIG Calculated Price	Excessive Profit	
				Amount	Percent
Defective Data and Unacceptable Quantity Curve	4	\$2,597,957	\$562,605	\$2,035,352	361.8
Excessive Subcontractor Prices and Pass-Through Costs	5	26,040,569	15,680,534	10,360,034*	66.1
Sikorsky Negotiated Lower Prices with Suppliers	19	9,724,009	5,523,645	4,200,364	76.0
<b>Subtotal - Significant Pricing Issues</b>	<b>28</b>	<b>\$38,362,536*</b>	<b>\$21,766,785*</b>	<b>\$16,595,751*</b>	<b>76.2</b>
Contract Prices Were Slightly Higher Than Costs	15	15,671,244	13,265,620	2,405,623*	18.1
Costs Were Higher Than Contract Prices	3	8,218,866	8,803,019	(584,153)	(6.6)
<b>Subtotal – Minor Pricing Issues</b>	<b>18</b>	<b>\$23,890,110</b>	<b>\$22,068,640*</b>	<b>\$1,821,471*</b>	<b>8.3</b>
<b>Total</b>	<b>46</b>	<b>\$62,252,646</b>	<b>\$43,835,424*</b>	<b>\$18,417,221*</b>	<b>42.0</b>
*Slight rounding inconsistencies exist because auditor calculations included decimal places.					

See Appendix B for a comparison of the 2010 CCAD/Sikorsky contract and OIG-calculated unit prices.

### ***Sikorsky Owes Refunds for Defective Certified Cost or Pricing Data and Unacceptable Quantity Curve***

Sikorsky had information that was reasonably available before the material certification cutoff dates that was not used to support CCAD/Sikorsky contract prices for the aircraft safety belt (sample 79), the junction box cover (sample 248), and the indicating light panel (sample 263), valued at \$1.1 million. The correct price was \$287,723, a difference of \$811,056 or 281.9 percent. Sikorsky has agreed to provide refunds for each of the three parts. By correcting the contract prices, AMCOM officials will avoid costs of \$690,379 over the remainder of the CCAD/Sikorsky contract.

Sikorsky also used an unacceptable quantity curve [REDACTED] to establish the price for the rotor (sample 36), valued at \$922,437. The correct price was \$236,144, a difference of \$686,293 or 290.6 percent. AMCOM officials need to pursue a refund for the excessive prices paid.

Table 3 summarizes the refunds due for defective data and the questionable quantity curve used.

**Table 3. Parts for Which Sikorsky Needs to Provide a Refund and Correct Prices**

Sample Number	NSN	Contract Price	OIG Calculated Price	Excessive Profit		Refund
				Amount	Percent	
Procured (2008–2010)						
Defective Data						
79	1680013803819	\$575,864				Pending
248	5975014243604	172,074				Pending
263	6220013068980	350,842				Pending
Subtotal		\$1,098,779*	\$287,723	\$811,056*	281.9	
Unacceptable Quantity Curve						
36	1615012212603	\$922,437	\$236,144	\$686,293	290.6	
Total		\$2,021,216	\$523,867	\$1,497,349	285.8	
Planned Contract Quantities (2011–2012)						
Defective Data						
79	1680013803819	\$550,461				
248	5975014243604	269,126				
263	6220013068980	112,238				
Subtotal		\$931,825	\$241,445	\$690,379*	285.9	
Unacceptable Quantity Curve						
36	1615012212603	\$1,666,133	\$321,160	\$1,344,973	418.8	
Total		\$2,597,957*	\$562,605	\$2,035,352	361.8	
*Slight rounding inconsistencies exist because auditor calculations included decimal places.						

The AMCOM contracting officer needs to obtain Sikorsky refunds of about \$1.5 million for NSNs 1680-01-380-3819, 5975-01-424-3604, 6220-01-306-8980, and 1615-01-221-2603, which were priced with defective data or an unacceptable quantity curve, and to correct prices for contract years 2011 and 2012 to avoid excessive profits totaling about \$2.0 million. [Recommendation 2.b(1)]

### **Sample 79 – Aircraft Safety Belt (NSN 1680-01-380-3819) (Quantity and Quote Issue – Better Data Available Before Material Certification Cutoff Date)**

Sikorsky had information that was reasonably available before the material certification cutoff date for the aircraft safety belt. On January 15, 2008, Sikorsky received a vendor quote from [REDACTED] at a unit price of [REDACTED]. On January 24, 2008, Sikorsky issued a purchase order [REDACTED] at a unit price of [REDACTED]. However, Sikorsky officials stated that they canceled this purchase order because the quantity requirement changed [REDACTED]. Sikorsky issued a new purchase order on February 1, 2008, [REDACTED] at a unit

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price of [REDACTED] While the requirements were reduced in the initial year of the contract, the quantity [REDACTED] is not representative of the Army's annual demand of about 90 per year and the contract price should have been adjusted for realistic demand.

On March 14, 2008, [REDACTED] quoted a quantity range [REDACTED] at a unit price of [REDACTED] However, according to Sikorsky officials, the quote was not received until May 19, 2008, after the cutoff date of May 8, 2008, so it was not considered in developing the contract price. Clearly, the correct price should have been based on unit costs of [REDACTED] and this information was reasonably available before the cutoff date. Sikorsky has agreed to provide a refund for the aircraft safety belt and correct the contract price.

We calculated that since 2008, AMCOM officials have paid excessive profits of [REDACTED] on this item. Specifically, AMCOM officials purchased 159 aircraft safety belts at a 2010 contract unit price of \$2,959.57, resulting in a total price of \$470,572. However, using the March 14, 2008, quote of [REDACTED] with Sikorsky's [REDACTED] wrap rate (burden), we calculated that the contract unit price should have been [REDACTED], which results in a total price of [REDACTED] Table 4 shows the pricing information, and Figure 2 shows the aircraft safety belt used on the Blackhawk helicopter.

**Table 4. Sample 79 – Pricing Information for the Aircraft Safety Belt**

	Date	Quantity	Unit Price	Percent Difference
AMCOM Procurement (Pacific Scientific)	4/2004	1,870	\$700.00	
[REDACTED] Quote	1/15/2008	[REDACTED]	[REDACTED]	
Cancelled [REDACTED] Purchase Order	1/24/2008	[REDACTED]	[REDACTED]	
[REDACTED] Purchase Order - (Used as Basis for Contract Negotiation)	2/1/2008	[REDACTED]	[REDACTED]	
[REDACTED] Quote	3/14/2008	[REDACTED]	[REDACTED]	
Burdened [REDACTED] Quote	3/14/2008	[REDACTED]	[REDACTED]	
<b>Material Certification Cutoff Date - May 8, 2008</b>				
[REDACTED] Purchase Order –	7/7/2010	[REDACTED]	[REDACTED]	
CCAD/Sikorsky Contract Negotiated/Procured Quantity	2008	92/0	<b>2,736.29</b>	[REDACTED]
	2009	98/37	<b>2,845.74</b>	[REDACTED]
	2010	94/159	<b>2,959.57</b>	[REDACTED]
	2011	79	<b>3,077.95</b>	[REDACTED]
	2012	96	<b>3,201.07</b>	[REDACTED]

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**Figure 2. Sample 79 – Aircraft Safety Belt**



**Sample 248 – Junction Box Cover (NSN 5975-01-424-3604)  
(Quote Issue – Better Data Available Before Material Certification  
Cutoff Date)**

Sikorsky had information that was reasonably available before the material certification cutoff date for the junction box cover. Specifically, Sikorsky failed to use the September 18, 2006, certified proposal [REDACTED] with a unit price of [REDACTED] in its price proposal. Instead, Sikorsky used a not-to-exceed long-term agreement [REDACTED], valid from June 21, 2007, through December 31, 2012, to

*The 2010 contract price of \$2,393.41 was [REDACTED] higher than the fair and reasonable price of [REDACTED].*

establish its price. The not-to-exceed price was [REDACTED], significantly higher than the certified proposal. After applying Sikorsky's burdens and profit, the negotiated 2009 contract unit price was \$2,301.35.

Sikorsky's previous purchase history for this item shows that the prices paid to its suppliers were never higher than [REDACTED] each. At a minimum, Sikorsky's prior purchase history for this item should have been a red flag that the not-to-exceed unit price of [REDACTED] was not valid to determine a fair and reasonable price and more scrutiny was warranted. This is an example where price analysis needed to be conducted in conjunction with cost analysis to determine price reasonableness. As a result, the 2010 contract unit price of \$2,393.41 was [REDACTED] higher than the fair and reasonable price of [REDACTED].

We calculated that AMCOM officials have paid [REDACTED] in excessive profits for this item since 2008. We calculated that for 2010, AMCOM officials paid excessive profits [REDACTED] for the 19 junction box covers purchased. Specifically, AMCOM officials paid a total of \$45,475 (unit price: \$2,393.41); however, the 19 junction box covers should have cost [REDACTED] based on the [REDACTED] long-term agreement price plus the Sikorsky wrap rate of [REDACTED] (burden). Sikorsky agreed to provide a

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refund for the junction box cover. Correcting the 2011 and 2012 contract prices will avoid excessive prices of [REDACTED] based on planned contract quantities. Table 5 shows the pricing information, and Figure 3 shows the junction box cover used on the Blackhawk helicopter. The difference between the not-to-exceed quote used as the basis for the proposal and negotiated subcontractor costs is shown in red in the table below.

**Table 5. Sample 248 – Pricing Information for Junction Box Cover**

	Date	Quantity	Unit Price	Percent Difference
AMCOM Procurement (Sikorsky)	6/2008	286	\$181.70	
[REDACTED] Certified Proposal	9/18/2006	[REDACTED]	[REDACTED]	
Sikorsky Purchase Order [REDACTED]	6/6/2007	[REDACTED]	[REDACTED]	
Sikorsky Not-To-Exceed Long-Term Agreement [REDACTED]	12/5/2007	[REDACTED]	[REDACTED]	
<b>Material Certification Cutoff Date – April 8, 2008</b>				
Sikorsky Defintized Long-Term Agreement – [REDACTED]	5/2/2008	[REDACTED]	[REDACTED]	
Burdened Sikorsky Purchase Contract [REDACTED]	5/2/2008	[REDACTED]	[REDACTED]	
CCAD/Sikorsky Contract Negotiated/Procured Quantity	2008	16/26	2,213.56*	[REDACTED]
	2009	23/30	2,301.35	[REDACTED]
	2010	43/19	2,393.41	[REDACTED]
	2011	53	2,489.14	[REDACTED]
	2012	53	2,588.71	[REDACTED]
*Weighted average of the two bridge contract unit prices based on contract quantity.				

**Figure 3. Sample 248 – Junction Box Cover**



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**Sample 263 – Indicating Light Panel (NSN 6220-01-306-8980)  
(Quote Issue – Better Data Available Before Material Certification  
Cutoff Date)**

Sikorsky had information that was reasonably available before the material certification cutoff date for the indicating light panel. The CCAD/Sikorsky contract price was based on a February 1, 2008, quote from [REDACTED] for a unit price of [REDACTED] provided to Derco Aerospace.<sup>3</sup> During the audit, we obtained another quote received by Derco Aerospace from [REDACTED], for a unit price of [REDACTED] (purchase order unit price: [REDACTED]). The quote was received on January 30, 2008, 2 days before the [REDACTED] quote, which was used as the basis for the proposal. As a result, we calculated that AMCOM paid excessive profits of [REDACTED] for the indicating light panel. In 2010, the total price paid was \$241,839 (unit price: \$3,778.74) for the 64 indicating light panels purchased; however, the total price should have been [REDACTED] based on the unit price of [REDACTED] ([REDACTED] plus Sikorsky wrap rate). After Sikorsky was informed of the documentation we obtained, Sikorsky agreed to issue a refund for the indicating light panel and correct the contract unit price. Table 6 shows the pricing information, and Figure 4 shows the indicating light panel used on the Blackhawk helicopter.

**Table 6. Sample 263 – Pricing Information for the Indicating Light Panel**

	Date	Quantity	Unit Price	Percent Difference
DLA Procurement (Sun Dial)	5/6/2008	185	\$138.00	
DLA Standard Unit Price (Inventory)	FY 2010	ANY (54)	194.58	
	FY 2011	ANY (61)	189.76	
Sikorsky Quote [REDACTED]	1/30/2008	[REDACTED]	[REDACTED]	
Sikorsky Quote [REDACTED]	2/1/2008	[REDACTED]	[REDACTED]	
<b>Material Certification Cutoff Date – April 8, 2008</b>				
Sikorsky Purchase Order - [REDACTED]	10/6/2009	[REDACTED]	[REDACTED]	
Burdened Sikorsky Purchase Order - [REDACTED]	10/6/2009	[REDACTED]	[REDACTED]	
CCAD/Sikorsky Contract Negotiated/Procured Quantity	2008	142/0	<b>3,483.51*</b>	[REDACTED]
	2009	58/30	<b>3,633.41</b>	[REDACTED]
	2010	12/64	<b>3,778.74</b>	[REDACTED]
	2011	14	<b>3,929.89</b>	[REDACTED]
	2012	14	<b>4,087.09</b>	[REDACTED]
*Weighted average of the two bridge contract unit prices based on contract quantity.				

<sup>3</sup> Derco Aerospace is a wholly owned subsidiary of Sikorsky, which performs procurement and warehousing functions for the CCAD/Sikorsky contract.

**Figure 4. Sample 263 – Indicating Light Panel**



### **Sikorsky Voluntary Refund on 25 Derco Aerospace Managed Parts**

On October 22, 2010, Sikorsky sent a voluntary refund proposal totaling \$219,371 for 25 parts that Derco Aerospace managed. Sikorsky officials stated that [REDACTED]

AMCOM officials had ample time to correct the contract unit prices for these 25 parts before the next option year started on December 1, 2010. However, as of March 9, 2011, AMCOM officials had not corrected the contract unit prices for 2011 and 2012. If the contract unit prices for these 25 parts are not corrected, the Army will pay additional excessive profits of [REDACTED] in 2011 and 2012 based on planned contract quantities. In addition, Sikorsky provided a refund proposal on August 31, 2010, for the indicating light panel (sample 263) discussed previously, but again as of March 9, 2011, no action had been taken. In total, Sikorsky has agreed to refunds of about \$1.0 million, and AMCOM officials have requested that DCAA review the proposals. *The AMCOM contracting officer needs to obtain Sikorsky refunds of \$219,371 for the 25 Derco Aerospace parts and correct the 2011 and 2012 contract unit prices.* [Recommendation 2.b(2)]

### **Sample 36 – Rotor (NSN 1615-01-221-2603) (Unacceptable Quantity Curve [REDACTED])**

Sikorsky-proposed prices for the rotor were based on a quantity curve [REDACTED]. [REDACTED] Derco Aerospace, who quoted the price for Sikorsky, discussed the prices for the rotor with its supplier [REDACTED]

[REDACTED] Therefore, the quote for an uneconomic order quantity was the basis for the contract proposal. Quoting a quantity of [REDACTED] is not effective in obtaining a fair and reasonable price and does not represent the best value for AMCOM.

Table 7 shows the pricing information, and Figure 5 shows the rotor used on the Blackhawk helicopter.

**Table 7. Sample 36 – Pricing Information for the Rotor**

	Date	Quantity	Unit Price	Percent Difference
Derco Price Basis	4/2008			
Derco Price Basis Quantity Curve	4/2008			
DLA Standard Unit Price - Honeywell (Inventory)	FY 2008	ANY	1,986.47	
	FY 2009	ANY	2,007.45	
	FY 2010	ANY (35)	<b>2,378.77</b>	
	FY 2011	ANY (34)	1,536.65	
CCAD/Sikorsky Contract Negotiated/Procured Quantity	2008	113/24	<b>11,087.10*</b>	366.1
	2009	90/69	<b>7,225.30</b>	203.7
	2010	77/21	<b>7,514.31</b>	215.9
	2011	104	<b>7,814.88</b>	228.5
	2012	105	<b>8,127.48</b>	241.7

\*Weighted average of two bridge contract unit prices based on purchase quantity.

**Figure 5. Sample 36 – Rotor**



As shown in Table 7, the use of an unacceptable quantity curve increased the subcontractor unit price from . The table also

*The use of an unacceptable quantity curve increased the subcontractor unit price from*

shows that the DLA standard unit price negotiated with Honeywell ranged from \$1,986.47 to \$2,378.77. However, the significant price increase went undetected because Sikorsky and AMCOM officials did not perform

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adequate price analysis on the proposed contract unit prices that ranged from \$7,225.30 to \$11,087.10. We calculated that AMCOM officials paid excessive prices totaling \$686,293, or 290.6 percent, more than necessary by procuring the rotor through Sikorsky rather than DLA (see Table 8).

**Table 8. Procuring the Rotor From DLA Would Have Saved Money**

Year	Qty	CCAD/Sikorsky Contract Price		DLA Standard Unit Price		Excessive Price	
		Unit	Total	Unit	Total	Amount	Percent
2008	24	\$11,087.10	\$266,090	\$1,986.47	\$47,675	\$218,415	458.1
2009	69	7,225.30	498,546	2,007.45	138,514	360,032	259.9
2010	21	7,514.31	157,801	2,378.77	49,954	107,846*	215.9
	<b>114</b>		<b>\$922,437</b>		<b>\$236,144*</b>	<b>\$686,293</b>	<b>290.6</b>
*Slight rounding inconsistencies exist because auditor calculations included decimal places.							

Clearly, basing prices on a quantity of [REDACTED] when the planned and actual usage by the Army is significantly higher is wrong. We believe Sikorsky, as the overseer for Derco Aerospace actions and AMCOM's procurement manager, bears the responsibility to correct the pricing and refund the excessive prices paid for the rotor.

DLA Aviation has negotiated a much lower price for the Honeywell Rotor under a long-term contract that uses a process called "one-pass pricing." In one-pass pricing, a group of DoD pricing experts provides real-time advice to the DLA Aviation contracting officer reviewing the Honeywell cost data used to support the proposed/negotiated price. This rotor also was included in a repricing event as part of a DoD Lean Six Sigma Project, "DLA/Honeywell Long-Term Contract Model Using One-Pass Pricing for Sole-Source Spare Parts," which included representatives from the DoD OIG team that also performed this audit; DLA Aviation; the DoD Lean Six Sigma Project Office; and Honeywell. As part of the repricing event, DLA Aviation was able to negotiate a lower unit price for the Honeywell rotor from \$1,737.70 to \$1,098.39 (based on an economic order quantity of 10 and up). The FY 2011 DLA standard unit price for this item is \$1,536.65, or a difference of 408.6 percent from the 2011 CCAD/Sikorsky contract unit price of \$7,814.88. We commend the DLA Aviation contracting officer and cost/price analyst for their ability to negotiate a lower price for the Honeywell rotor.

Unfortunately, the new unit prices may never be realized because DLA currently has stock on hand of 34 items and a monthly consumption quantity of less than 1 or about 6 parts per year. Therefore DLA will not procure the item again for almost 6 years, and AMCOM plans to meet CCAD requirements of 105 per year on the CCAD/Sikorsky contract.



As shown in Table 9, over the next 2 years, the Army expects to buy 209 of the [REDACTED] rotor from Sikorsky and spend about \$1.3 million or 418.7 percent more by procuring the [REDACTED] rotor available from DLA.

**Table 9. DLA Prices Are Much Lower Than the CCAD/Sikorsky Contract Prices for the [REDACTED] Rotor (Sample 36)**

Year	Qty	CCAD/Sikorsky Contract Price		DLA Standard Unit Price		Total Difference	
		Unit Price	Total Price	Unit Price	Total Price	Amount	Percent
2011	104	\$7,814.88	\$812,748	\$1,536.65	\$159,812	\$652,936	408.6
2012	105	8,127.48	853,385	1,536.65	161,348	692,037	428.9
	<b>209</b>		<b>\$1,666,133</b>		<b>\$321,160</b>	<b>\$1,344,973</b>	<b>418.7*</b>
*Slight rounding inconsistencies exist because auditor calculations included decimal places.							

AMCOM officials need to procure or have Sikorsky procure NSN 1615-01-221-2603 from DLA Aviation to save about \$1.3 million over the next 2 years based on planned contract quantities and help protect war fighter resources. [Recommendation 2.b(3)]

### **Excessive Subcontractor Prices and Pass-Through Costs**

Sikorsky and AMCOM accepted unreasonable price increases from suppliers resulting in excessive pass-through costs. Table 10 shows the five parts that had excessive pass-through charges. In the following section, we discuss price increases for each part.

**Table 10. Excessive Subcontractor Prices and Pass-Through Costs**

Sample Number	NSN	Contract Price	OIG Calculated Price	Excessive Profit	
				Amount	Percent
Procured (2008–2010)					
1	1615013900740	\$20,102,956	\$13,478,916	\$6,624,040	49.1
234	1560011867122	241,293			
258	1560011259938	230,235			
293	1560011259937	214,965			
332	1560011153667	157,542			
Subtotal		\$20,946,991	\$13,951,919	\$6,995,072	50.1
Planned Contract Quantities (2011–2012)					
1	1615013900740	\$25,075,375	\$15,196,352	\$9,879,022*	65.0
234	1560011867122	259,989			
258	1560011259938	275,629			
293	1560011259937	259,545			
332	1560011153667	170,033			
Subtotal		\$26,040,569*	\$15,680,534*	\$10,360,034*	66.1
Total		\$46,987,560	\$29,632,453	\$17,355,106*	58.6
*Slight rounding inconsistencies exist because auditor calculations included decimal places.					

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The AMCOM contracting officer needs to obtain refunds of about \$7.0 million from Sikorsky for excessive supplier costs and correct prices to avoid excessive profits totaling about \$10.4 million for NSNs 1615-01-390-0740, 1560-01-186-7122, 1560-01-125-9937, 1560-01-125-9938, and 1560-01-115-3667. [Recommendation 2.b(4)]

### Sample 1 – Titanium Blade Sheath Assembly (NSN 1615-01-390-0740)

Sikorsky did not negotiate fair and reasonable prices or perform adequate cost or price analyses for the titanium blade sheath assembly even though the price increased 114.3 percent from \$7,936.57 each in 2007 to \$17,004.39 each in 2008. The titanium blade sheath assembly is the top dollar item on the contract with average total procurements of about \$14 million annually. Multi-million-dollar subcontractor price increases need to be thoroughly evaluated and justified. Table 11 details the unit prices for the titanium blade sheath assembly from the initial CCAD/Sikorsky contract through the current contract.

**Table 11. Titanium Blade Sheath Assembly Prices (Price Analysis)**

Year	Contract Quantity	Unit Price	Total	Percent Change
2004	698	\$ 7,917.71	\$ 5,526,562	
2005	134	7,798.67	1,045,022	(1.5)
2006	878	7,843.77	6,886,830	0.6
2007	608	7,936.57	4,825,435	1.2
<b>2008<sup>1</sup></b>	<b>517</b>	<b>17,004.39<sup>2</sup></b>	<b>8,791,270</b>	<b>114.3</b>
2009	797	17,683.90	14,094,068	4.0
2010	324	18,391.26	5,958,768	4.0
2011	583	19,126.91	11,150,989	4.0
2012	700	19,891.98	13,924,386	4.0

<sup>1</sup>Price was negotiated based on 5-year fixed-price agreement.  
<sup>2</sup>The price is a weighted average of the two bridge contracts.

Sikorsky did not obtain cost or pricing data from all [REDACTED] subcontractors despite each of their proposals being well over the cost or pricing data threshold of \$650,000 (currently \$700,000).

*Multi-million-dollar subcontractor price increases need to be thoroughly evaluated and justified.*

[REDACTED] Sikorsky did receive cost or pricing data from [REDACTED] its first tier subcontractor. However, without a review of supplier costs below [REDACTED] there was little assurance that the price proposed was fair and reasonable. Further, the Sikorsky cost or price analysis conducted in September 2006 was inadequate because it only addressed the long-term agreement with [REDACTED] as a whole and did not review individual part prices.

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Figure 6 shows the titanium blade sheath assembly used on the Blackhawk Helicopter.

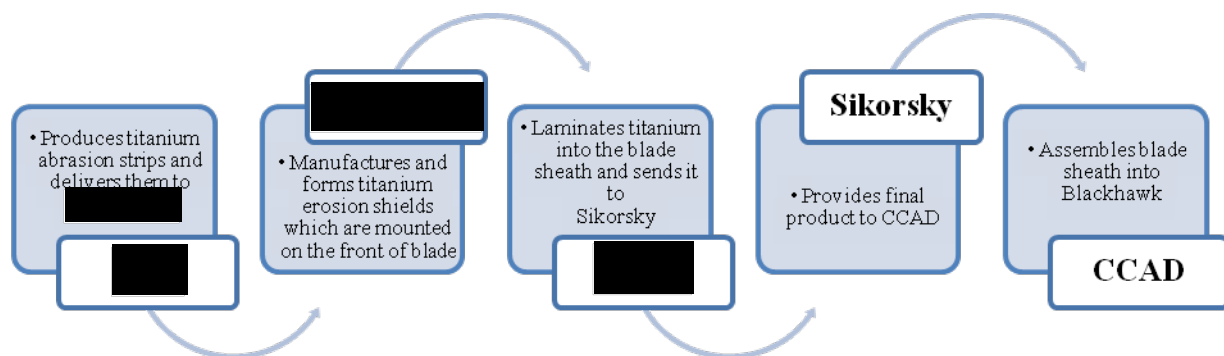
**Figure 6. Sample 1 – Titanium Blade Sheath Assembly**



Source: DLA Distribution Susquehanna, Pennsylvania

**Long-Term Fixed-Price Agreement to Establish Predictable Profits.** As the initial CCAD/Sikorsky contract was ending, Sikorsky began negotiations for a long-term fixed-price agreement with its suppliers for titanium blade sheath assembly for the follow-on contract. Figure 7 shows a flow chart of the manufacturing process and each company's role in producing the titanium blade sheath assembly.

**Figure 7. Titanium Blade Sheath Assembly Manufacturing Process**



Sikorsky, [redacted] signed the agreement in late October 2007, which established a firm fixed price for the blade sheath. [redacted] finalized the agreement by signing in January 2008. The agreement established fixed prices for delivery of the titanium blade sheath assemblies from January 1, 2008, through December 31, 2012. Under the terms of the agreement, [redacted] and [redacted] price to Sikorsky was [redacted] per unit. [redacted]

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[REDACTED] even though the CCAD/Sikorsky contract permitted contract prices to escalate 4 percent annually.

[REDACTED] over the course of the CCAD/Sikorsky contract due to the escalation clause in the prime contract.

**Suppliers Made Excessive Profits for the Blade Sheath Assembly.** By performing cost analysis we determined that all suppliers made excessive profits. We calculated a fair and reasonable price of \$11,844.39 each versus the CCAD/Sikorsky contract price of \$18,391.26, a difference of 55.3 percent, by applying the contract negotiated profit of [REDACTED] percent to each supplier's costs. Overall, [REDACTED] made [REDACTED] percent profit on supplying the titanium abrasion strips; [REDACTED] made [REDACTED] percent profit on supplying the titanium erosion shields; [REDACTED] made [REDACTED] percent profit on supplying the titanium blade sheath assembly; and Sikorsky made a [REDACTED] percent profit supplying the item to CCAD in 2010 and the profit will increase annually by 4 percent through 2012 due to the contract escalation clause.

Table 12 details each contractor's cost, price, profit, and the OIG-calculated cost-based price. Contractor profits are highlighted in yellow.

**Table 12. Excessive Supplier Profits for Blade Sheath Assembly (Cost Analysis)**

Description	Unit Costs		Excessive Profit	
	Contract	OIG-calculated*	Amount	Percent
Cost				
Profit				
Price				
Cost				
Additional Material				
Labor				
Burdens				
Subtotal				
Profit				
Price				
Cost				
Additional Material				
Total Material				
Material Burden				
Material Subtotal				
Labor				
Labor Burden				
Labor Subtotal				
Subcontract Total				
Total				
Scrap				
Total Factory Cost				
General and Administrative				
Cost of Money				
Total Cost				
Profit				
Price				
Cost				
Burdens				
Subtotal				
Profit				
CCAD/Sikorsky Contract Price	\$18,391.26	\$11,844.39	\$6,546.87	55.3

\*We applied the burden amounts as proposed and would expect them to be less if costs are reduced.

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**Prices for Titanium Were Not Representative of Market Prices, Causing Excessive Pass-Through Costs.** The CCAD/Sikorsky contract did not have an economic price adjustment clause that would reduce risks associated with market fluctuations. According to Sikorsky, the Government insisted on a firm fixed price for the current contract. As a result, the price of the titanium blade sheath assembly increased significantly, and Sikorsky ensured that it would not suffer loss related to the volatility of the titanium market.

Specifically, in 2005, the titanium ingot market increased from about \$10 to \$22.13 per pound. The high prices for titanium ingot continued through 2006 and 2007, reaching a high of \$27.75 per pound in 2006 and \$27.21 per pound in 2007. Figure 8 shows the history of titanium ingot pricing since 2004.

**Figure 8. Titanium Ingot Prices From 2004 Through 2010**



After the CCAD/Sikorsky contract price was negotiated in the 2007-2008 timeframe, the price of titanium ingot started to decrease significantly and in 2010, the price ranged from \$8.25 to \$11.00 per pound. Despite the drastic decrease in prices, the savings were not passed to the Army because the long-term agreement fixed the price at the higher levels through 2012. *The contracting officer needs to consider using an economic price adjustment clause in the follow-on contract unless acceptable long-term prices for titanium can be negotiated.* [Recommendation 2.b(5)]

**AMCOM and DCMA Did Not Perform Adequate Price Analysis.** Neither AMCOM nor DCMA officials performed adequate price analysis from the initial contract price and as a result did not question Sikorsky on reasons for large increases. In addition, AMCOM officials did not review any costs or prices in detail and relied solely on DCMA to determine price reasonableness for the follow-on contract. DCMA and DCAA advice and support are designed to assist the contracting officer in determining price



reasonableness. However, the support was never intended to serve as the Government's sole representation in negotiating and determining price reasonableness. FAR 15.404-3 assigns the responsibility of determining price reasonableness to the contracting officer. Therefore, the contracting officer must be involved in reviewing cost data and performing price analysis. Normally, an experienced cost/price group can assist the contracting officer in meeting this responsibility. However, the Director, Aviation Logistics, AMCOM Contracting Center, stated that a cost/price group is being developed to assist AMCOM contracting officers but is not yet functional. For this reason, we will not be making a recommendation for AMCOM to review the actions of the contracting officer.

For the titanium blade sheath assembly, DCMA officials reviewed Sikorsky's cost of [REDACTED], which was supported on a negotiated contract with [REDACTED] but failed to perform a price analysis comparing the proposed price with previous contract prices. As a result, the 114.3 percent price increase for the titanium blade sheath assembly from the initial CCAD/Sikorsky contract went largely undetected and resulted in AMCOM paying excessive profits and not questioning the increases or requiring support for increased subcontractor prices.

If the Army or DCMA had performed price analysis, they would have discovered the significant price increase and could have further questioned Sikorsky as to the reasonableness of the price. An effective analysis of proposed prices must include both analysis of proposed costs and a comparison of valid prior prices. Performing cost analysis in isolation is high risk as the results may incorrectly show that the proposed price is adequate. However, cost analysis alone will not uncover a significant price increase from the previous procurement. *AMCOM needs to develop procedures that require contracting officers or other oversight officials to perform adequate price analysis in conjunction with cost analysis to determine price reasonableness, obtain adequate support for large price increases, and ensure that multi-tier subcontractor prices are adequately evaluated.* [Recommendation 2.a – Internal Control]

**Impact of Excessive Prices.** The long-term fixed price agreement established predictable profits for Sikorsky and its subcontractors in supplying the titanium blade sheath assembly to CCAD. Based on actual sales of 1,138 titanium blade sheath assemblies from December 1, 2007 through November 30, 2010, we calculated that AMCOM officials have paid excessive profits of approximately \$6.6 million for this item. AMCOM officials will pay another \$9.9 million in excessive profit for 2011 and 2012 (based on planned sales of 1,283), if the contract price for the titanium blade sheath assembly is not corrected.

Table 13 details the excessive profit paid for the titanium blade sheath assembly.

**Table 13. Excessive Profit for the Titanium Blade Sheath Assembly**

Year	Procured	Contract Price <sup>1</sup>	OIG Cost-Based Unit Price	Total Contract Price	Total OIG Cost-Based Price	Excessive Profit	
						Amount	Percent
2008	248	\$17,004.39 <sup>2</sup>	\$11,844.39	\$4,217,089	\$2,937,410 <sup>3</sup>	\$1,279,680 <sup>3</sup>	43.6
2009	682	17,683.90	11,844.39	12,060,420	8,077,877 <sup>3</sup>	3,982,543	49.3
2010	208	18,391.26	11,844.39	3,825,382	2,463,634 <sup>3</sup>	1,361,748	55.3
<b>Subtotal</b>	<b>1,138</b>			<b>\$20,102,891</b>	<b>\$13,478,921</b>	<b>\$6,623,970<sup>3</sup></b>	<b>49.1</b>
<b>Planned Contract Quantities</b>							
2011	583	19,126.91	11,844.39	11,150,989	6,905,282 <sup>3</sup>	4,245,706 <sup>3</sup>	61.5
2012	700	19,891.98	11,844.39	13,924,386	8,291,076 <sup>3</sup>	5,633,310	67.9
<b>Subtotal</b>	<b>1,283</b>			<b>\$25,075,375</b>	<b>\$15,196,358</b>	<b>\$9,879,016<sup>3</sup></b>	<b>65.0</b>
<b>Total</b>	<b>2,421</b>			<b>\$45,178,266</b>	<b>\$28,675,279</b>	<b>\$16,502,987<sup>3</sup></b>	<b>57.6</b>

<sup>1</sup>Contract prices were inflated 4 percent annually [REDACTED]

<sup>2</sup>We calculated a weighted average of the two bridge contract unit prices.

<sup>3</sup>Slight rounding inconsistencies exist because auditor calculations included decimal places.

### **Samples 234, 258, 293, and 332 (From [REDACTED])**

Sikorsky officials did not negotiate fair and reasonable prices or perform adequate cost or price analysis to establish the reasonableness of the proposed prices for four items [REDACTED] resulting in excessive pass-through charges. We calculated that for the four items in our sample, AMCOM officials paid excessive profit of [REDACTED], on sales of \$844,035.

[REDACTED] prices for the four items increased significantly, ranging from [REDACTED]. For example, the unit price for sample 234, aircraft structural panel (NSN 1560-01-186-7122) increased [REDACTED]. These types of increases over a period of just a few months should have caused Sikorsky, the AMCOM buying manager, to question the price reasonableness of the proposed prices and scrutinize these large increases.

Figure 9 shows the four [REDACTED] parts used on the Blackhawk helicopter.

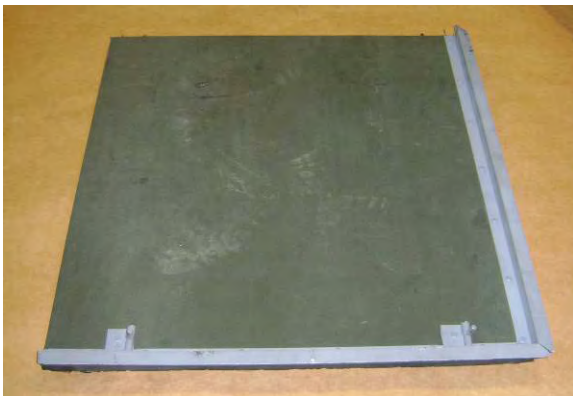
**Figure 9. Four [REDACTED] Parts Reviewed**



**Sample 234 – Aircraft Structural Panel**



**Sample 258 – Left Aircraft Access Door**



**Sample 293 – Right Aircraft Access Door**



**Sample 332 – Ceiling Panel Assembly**

Sikorsky's cost or price analysis, completed in July 2007, was not adequate, merely recommended negotiation objectives from the [REDACTED] proposal, and did not address whether the proposed prices were fair and reasonable. From our review of prices for the four items, it appeared that Sikorsky accepted [REDACTED] prices as proposed and passed on the significant price increases to AMCOM. As the buying manager for AMCOM, Sikorsky needs to obtain fair and reasonable prices from its subcontractors. However, because Sikorsky has a fixed profit under the contract, it has no incentive to obtain the lowest price possible, because as subcontractor prices increase, its profits increase. This is a significant weakness in AMCOM's current strategy of using Sikorsky as its buying manager.

To illustrate Sikorsky's inherent incentive to pass on higher costs, consider the cost and pricing information for sample 258, left aircraft access door. We calculated that from 2008 through 2010, the Sikorsky profit was [REDACTED] based on the 96 doors that were sold at a total contract price of \$230,235, while the fully burdened total cost was [REDACTED]. Using [REDACTED] actual costs that we obtained during the audit, we calculated that Sikorsky's fully burdened costs should have been only [REDACTED], resulting in a contract price of [REDACTED]. That would equate to profit of only [REDACTED].

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██████████ for the 96 doors. Therefore, by passing on higher costs to AMCOM for the left aircraft access doors, Sikorsky made additional profits of ██████████ (see Table 14).

**Table 14. Additional Sikorsky Profit for Passing on Higher Costs for 96 Left Aircraft Access Doors Purchased (Sample 258)**

Description	Cost		Price		Profit
	Unit	Total	Unit	Total	
Negotiated	██████████	██████████	\$2,398.28	\$230,235	██████████
OIG-calculated	██████████	██████████	██████████	██████████	██████████
Difference					██████████

Table 15 lists the excessive profits paid through November 2010 for each item and the excessive profit that will be paid based on planned contract quantities for 2011 and 2012.

**Table 15. Excessive Profits on ██████████ Parts**

Sample	NSN	Contract Price	OIG Calculated Price	Excessive Profit	
				Amount	Percent
234	1560011867122	\$241,293	██████████	██████████	██████████
258	1560011259938	230,235	██████████	██████████	██████████
293	1560011259937	214,965	██████████	██████████	██████████
332	1560011153667	157,542	██████████	██████████	██████████
<b>Subtotal</b>		<b>\$844,035</b>	<b>\$473,003</b>	<b>\$371,032</b>	<b>78.4</b>
<b>Excessive Profit Based on Planned Contract Quantities for 2011 and 2012</b>					
234	1560011867122	\$259,989	██████████	██████████	██████████
258	1560011259938	275,629	██████████	██████████	██████████
293	1560011259937	259,545	██████████	██████████	██████████
332	1560011153667	170,033	██████████	██████████	██████████
<b>Subtotal</b>		<b>\$965,196</b>	<b>\$484,183</b>	<b>\$481,012*</b>	<b>99.3</b>
<b>Total</b>		<b>\$1,809,231</b>	<b>\$957,186</b>	<b>\$852,044*</b>	<b>89.0</b>
*Slight rounding inconsistencies exist because auditor calculations included decimal places.					

### ***Sikorsky Obtained Lower Prices After AMCOM Negotiations and Proposed Prices Based on Smaller Quantities Than It Purchased***

Sikorsky officials consistently negotiated lower firm prices with suppliers after prices were agreed to with AMCOM and also proposed prices based on significantly lower quantities. For 19 of the parts reviewed, we calculated that AMCOM paid \$11.7 million for parts that should have cost only \$8.4 million, or a difference of 39.0 percent. AMCOM officials need to request a refund from Sikorsky for these parts because Sikorsky made excessive profit.

Table 16 shows the 19 parts for which Sikorsky negotiated a lower price with its suppliers after negotiations with AMCOM and did not share savings with the Army. The sample parts highlighted are discussed in detail in the following section.

**Table 16. Sikorsky Negotiated Lower Prices With Its Suppliers After Negotiations With AMCOM**

Sample Number	NSN	Contract Price	OIG Calculated Price	Excessive Profit	
				Amount	Percent
Procured (2008–2010)					
8	3040014158388	\$3,499,974			
12	3040010957220	1,452,519			
29	3020011391321	1,092,416			
34	1615011342507	994,717			
44	1615013764398	714,281			
65	6115011456875	571,873			
66	5320014560634	20,767			
83	3040013686667	528,289			
104	6115011177281	188,200			
109	5320014561475	16,529			
113	3120010906519	554,257			
134	1560011735845	211,294			
156	6115011177238	221,686			
175	1615011026051	351,818			
228	3110011055802	239,421			
255	1680012737591	102,900			
285	5998011451798	155,961			
288	3040012893594	599,093			
330	5340011014086	208,329			
Subtotal		\$11,724,322*	\$8,437,580*	\$3,286,742*	39.0
Planned Contract Quantities (2011–2012)					
Subtotal	All 19 Parts	\$9,724,009	\$5,523,645	\$4,200,364	76.0
Total		\$21,448,332*	\$13,961,226*	\$7,487,106	53.6
* Slight rounding inconsistencies exist because auditor calculations included decimal places.					

*The AMCOM contracting officer needs to request a refund of about \$3.3 million from Sikorsky and correct contract prices to avoid excessive profits of about \$4.2 million for 2011 and 2012 for which lower prices were negotiated with suppliers shortly after prices were negotiated with the Army. [Recommendation 2.b(6)]*

Generally, the 19 parts fell into three categories: (1) Sikorsky negotiated a lower price with its supplier shortly after negotiating the contract price with AMCOM, (2) Sikorsky proposed the price to manufacture the item then procured the item directly from a supplier at a lower cost, or (3) Sikorsky negotiated a price with AMCOM using low

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quantities then purchased larger quantities at a lower price but did not pass on savings to the Army.

### **Sample 330 – Flush Door Ring (NSN 5340-01-101-4086) (Negotiated Lower Price After Negotiations With AMCOM)**

Sikorsky negotiated lower firm prices with its supplier after prices were agreed to with AMCOM for the flush door ring. The 2009 contract price of \$273.52 was based on a long-term agreement Sikorsky had with its supplier at a unit price of [REDACTED]. The material cost certification cutoff date was April 8, 2008. After the negotiation of the

*The 2010 contract unit price of \$284.46 is 4,495.5 percent higher than the previous DLA procurement.*

CCAD/Sikorsky contract price, Sikorsky negotiated and entered into a purchase order with a different supplier on June 13, 2009, to support requirements for

the remainder of the contract at a [REDACTED] unit price (valid through June 2013). As a result, we calculated that AMCOM officials paid excessive profits of [REDACTED] through 2010. In 2010, the total price paid was \$89,320 (unit price: \$284.46) for the 314 flush door rings purchased; however, the total price should have been [REDACTED] based on the unit price of [REDACTED] ([REDACTED] plus Sikorsky wrap rate). If pricing is not corrected, AMCOM officials will pay excessive profits of [REDACTED] in 2011 through 2012 based on planned quantities. The 2009 contract price of \$273.52 for a quantity of 161 was [REDACTED] higher than the most recent DLA procurement for this item. The 2010 contract unit price of \$284.46 is 4,495.5 percent higher than the previous DLA procurement made in February 2009 for a quantity of 906 for \$6.19 each (2007 DLA procurement was \$5.75 each). The 2010 DLA standard unit price is \$8.37. Figure 10 shows a picture and Table 17 shows the pricing information of the flush door ring used on the Blackhawk helicopter.

**Figure 10. Sample 330 – Flush Door Ring**



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**Table 17. Sample 330 – Pricing Information for the Flush Door Ring**

	Date	Quantity	Unit Price	Percent Difference
DLA Procurement (Troy Tube & Manufacturing)	9/2007	436	\$5.75	
DLA Procurement (Kampi)	2/2009	906	6.19	
DLA Standard Unit Price (Inventory)	FY 2010	ANY (545)	8.37	
	FY 2011	ANY (272)	8.82	
Sikorsky Long-Term Agreement [REDACTED]	4/12/2006	[REDACTED]	[REDACTED]	
Sikorsky Purchase Order - [REDACTED]	3/11/2008	[REDACTED]	[REDACTED]	
<b>Material Certification Cutoff Date – April 8, 2008</b>				
Sikorsky Purchase Order - [REDACTED]	6/13/2009	[REDACTED]	[REDACTED]	
Burdened Sikorsky Price [REDACTED]	6/13/2009	[REDACTED]	[REDACTED]	
CCAD/Sikorsky Contract Negotiated/Procured Quantity	2008	294/233	263.08*	[REDACTED]
	2009	161/211	273.52	[REDACTED]
	2010	304/314	284.46	[REDACTED]
	2011	384	295.84	[REDACTED]
	2012	384	307.67	[REDACTED]
*Weighted average of two bridge contract unit prices based on contract quantity.				

**Sample 29 – Pinion (NSN 3020-01-139-1321) (Make-to-Buy Issue)**

Sikorsky proposed this item as a make item to establish the 2009 CCAD/Sikorsky contract price of \$5,839.88. After the contract proposal was certified, Sikorsky then negotiated a long-term agreement with [REDACTED] which reduced its costs to [REDACTED] which was valid from September 29, 2008, to December 31, 2012. The 2010 contract price of \$6,073.48 is [REDACTED] higher than the fair and reasonable price. Thus, Sikorsky's decision to change from making this item to procuring it increased its profit dramatically. We calculated that AMCOM officials have paid Sikorsky excessive profits of [REDACTED] since 2008. For 2010, we calculated that AMCOM paid excessive profits of [REDACTED]. The total price was \$431,217 (unit price: \$6,073.48) for 71 pinions; however, the total price should have been [REDACTED] based on the unit price of [REDACTED] ([REDACTED] plus Sikorsky wrap rate). Based on planned contract quantities in 2011 and 2012, AMCOM officials will pay excessive profits of [REDACTED] if the price is not corrected.

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Table 18 shows the pricing information, and Figure 11 shows the pinion used on the Blackhawk helicopter.

**Table 18. Sample 29 – Pricing Information for the Pinion**

	Date	Quantity	Unit Price	Percent Difference
AMCOM Procurement (Canadian Commercial Corporation)	4/2001	370	\$3,629.22	
Sikorsky (Make Price)				
Sikorsky Long-Term Agreement – [REDACTED]	9/29/2008			
Burdened Sikorsky Long-Term Agreement - [REDACTED]	9/29/2008			
CCAD/Sikorsky Contract Negotiated/Procured Quantity	2008	144/43	5,714.40*	
	2009	144/71	5,839.88	
	2010	122/71	6,073.48	
	2011	84	6,316.42	
	2012	82	6,569.07	
*Weighted average of two bridge contract unit prices based on contract quantity.				

**Figure 11. Sample 29 – Pinion**



### **Sample 12 – Center Housing Assembly (NSN 3040-01-095-7220) (Make-to-Buy Issue)**

The proposed price for the center housing assembly was based on costs related to Sikorsky manufacturing the item. After negotiations with AMCOM, Sikorsky began to procure the item directly from a supplier for a lower price. Specifically, Sikorsky proposed this item as a make part to establish the 2009 CCAD/Sikorsky contract price of \$12,066 each. However, Sikorsky began purchasing this item in September 2008 and locked in a price of [REDACTED] from its supplier through June 2012. The 2010 contract price of \$12,548.19 is [REDACTED] higher than the burdened price of [REDACTED]. Additionally, Sikorsky profits will continue to grow each year because it locked in a price

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with its supplier through 2012, and the contract price allows escalation of 4 percent each option year. Since 2008, AMCOM officials paid Sikorsky excessive profits of [REDACTED]. In 2010, AMCOM officials paid excessive profits of [REDACTED] for six center housings. The total price paid was \$75,289 (unit price: \$12,548.19); however, the total price should have been [REDACTED], based on the unit price of [REDACTED] ([REDACTED] plus Sikorsky wrap rate). If the price is not corrected, AMCOM officials will pay excessive profits of [REDACTED] in 2011 and 2012 based on planned quantities. Table 19 shows the pricing information, and Figure 12 shows the center housing assembly used on the Blackhawk helicopter.

**Table 19. Sample 12 – Pricing Information for the Center Housing Assembly**

	Date	Quantity	Unit Price	Percent Difference
AMCOM Procurement (Purdy Corporation)	10/2004	242	\$5,640.00	
Sikorsky (Make Price)		[REDACTED]	[REDACTED]	
Sikorsky Long-term Agreement - [REDACTED]	9/17/2008	[REDACTED]	[REDACTED]	
Burdened Sikorsky Long-term Agreement - [REDACTED]	9/17/2008	[REDACTED]	[REDACTED]	
CCAD/Sikorsky Contract Negotiated/Procured Quantity	2008	147/89	11,772.34*	[REDACTED]
	2009	95/27	12,065.57	[REDACTED]
	2010	77/6	12,548.19	[REDACTED]
	2011	0	13,050.12	[REDACTED]
	2012	70	13,572.13	[REDACTED]
*Weighted average of two bridge contract unit prices based on contract quantity.				

**Figure 12. Sample 12 – Center Housing Assembly**



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### Sample 134 – Access Cover (NSN 1560-01-173-5845) (Quantity Issue)

Sikorsky negotiated prices with AMCOM using low quantities, then purchased larger quantities at a lower price but did not pass on savings to the Army. Sikorsky's proposed price for this item was based on a quantity that was not representative of the annual

*The negotiated contract price was based on a price of [REDACTED] for a quantity of [REDACTED] when AMCOM planned to procure more than 350 annually.*

contract demands. The negotiated contract price was based on a price of [REDACTED] for a quantity of [REDACTED] when AMCOM planned to procure more than 350 annually. Sikorsky procured larger quantities at a much lower price

[REDACTED] which inflated its profits for this item. Sikorsky's purchase history for this item ranged from [REDACTED] DLA procured 424 access covers from Parker Hannifin in June 2009 for \$139.04 each (\$128.21 in 2007). The current contract price of \$709.48 is 410.3 percent higher than the previous DLA purchase.

We calculated that AMCOM officials have paid excessive profits of [REDACTED] since 2008. In 2010, AMCOM officials paid [REDACTED] of excessive profits for 223 access covers. The total price was \$158,214 (unit price: \$709.48); however, the total price should have been [REDACTED], based on the unit price of [REDACTED] ([REDACTED] plus Sikorsky wrap rate). If prices are not corrected, AMCOM officials will pay an additional \$419,983 in 2011 and 2012 based on planned contract quantities. Table 20 shows the pricing information, and Figure 13 shows the access cover used on the Blackhawk helicopter.

**Table 20. Sample 134 – Pricing Information for the Access Cover**

	Date	Quantity	Unit Price	Percent Difference
DLA Procurement (Parker Hannifin)	6/2009	424	\$139.04	
DLA Standard Unit Price (Inventory)	FY 2010	ANY (753)	179.17	
	FY 2011	ANY (727)	205.08	
Sikorsky Purchase Order - [REDACTED] Used for Negotiation	3/22/2007	[REDACTED]	[REDACTED]	
Sikorsky Purchase Order - [REDACTED]	2/12/2009	[REDACTED]	[REDACTED]	
Sikorsky Purchase Order - [REDACTED]	11/30/2009	[REDACTED]	[REDACTED]	
Average Sikorsky Burdened Price		[REDACTED]	[REDACTED]	
CCAD/Sikorsky Contract Negotiated/Procured Quantity	2008	6/5	656.06*	[REDACTED]
	2009	4/73	682.19	[REDACTED]
	2010	223/223	709.48	[REDACTED]
	2011	437	737.85	[REDACTED]
	2012	437	767.37	[REDACTED]

\*Weighted average of two bridge contract unit prices based on contract quantity.

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**Figure 13. Sample 134 – Access Cover**



***Excessive Contract Escalation Not Based on Economic Index***

AMCOM officials agreed to an annual escalation factor of 4 percent to the negotiated contract price. The escalation factor was not based on an economic index and, according to the price negotiation memorandum, was considered representative of Sikorsky's historical experience of supplying parts to CCAD. According to the Bureau of Labor Statistics (BLS) producer price index for other aircraft parts and equipment, inflation in 2008 was 4.05 percent, 1.82 percent in 2009, and 0.35 percent in 2010. For 2011 and 2012, we applied escalation of 2.25 percent each year for aircraft parts based on the judgment and analysis of an Air Force Senior Cost/Price Analyst, who used Global Insight predictive indicators.

We calculated the difference between the contract escalation rate of 4 percent a year and the actual escalation experienced through 2010 and rational projection of the near term escalation beyond 2010. Our calculations showed that AMCOM officials paid excessive escalation of \$5.4 million through 2010. AMCOM officials will continue to pay excessive escalation: approximately \$6.9 million in 2011 and approximately \$8.7 million in 2012.

Therefore, over the entire contract period, we calculated that AMCOM officials will pay more than \$21.0 million in excessive profit because escalation was not based on an actual economic index (see Table 21).

**Table 21. Profits Paid Due to Excessive Contract Escalation**

Year	BLS <sup>1</sup>		Contract		Difference (Percent)	Disbursed Amount <sup>2</sup>	Excess Profit
	Escalation (Percent)	Compound Interest (Percent)	Escalation (Percent)	Compound Interest (Percent)			
2008	4.05	4.05	4.00	4.00	(0.05)	\$98,669,263	(\$49,335)
2009	1.82	5.94	4.00	8.16	2.22	96,730,380	2,143,826
2010	0.35	6.31	4.00	12.49	6.17	53,722,395	3,315,686
<b>Subtotal</b>						<b>\$249,122,038</b>	<b>\$5,410,177</b>
2011	2.25	8.71	4.00	16.99	8.28	83,040,679	6,875,159
2012	2.25	11.15	4.00	21.67	10.51	83,040,679	8,729,903
<b>Subtotal</b>						<b>\$166,081,359<sup>3</sup></b>	<b>\$15,605,062</b>
<b>Total</b>						<b>\$415,203,397</b>	<b>\$21,015,238<sup>3</sup></b>

<sup>1</sup>Rates for 2008 through 2010 are based on actual rates from the Bureau of Labor Statistics, while 2011 and 2012 rates are based on projections from an Air Force Senior Cost/Price Analyst.

<sup>2</sup>The disbursed amounts for 2008 through 2010 are actual disbursements. Disbursed amounts for 2011 and 2012 are an average of the disbursed amounts from 2008 through 2010.

<sup>3</sup>Slight rounding inconsistencies exist because auditor calculations included decimal places.

*The AMCOM contracting officer needs to request a voluntary refund of about \$5.4 million from Sikorsky for excessive profits paid from 2008 through 2010 that were caused by excessive escalation. Further, the contracting officer needs to account for and request a refund from Sikorsky for excessive escalation for 2011. The contracting officer should not exercise the next option year until contract escalation is based on an appropriate economic index and pricing has been corrected to avoid excessive escalation of \$8.7 million in 2012. [Recommendations 2.b(7) through 2.b(9)]*

FAR 16.203, “Fixed-price contract with economic price adjustment,” provides for an upward and downward revision of the contract price. Three general types of economic price adjustments defined are (1) adjustments based on established prices, (2) adjustments based on actual costs of labor or material, and (3) adjustments based on cost indexes of labor or material. FAR 16.203-3, “Limitations,” states that “A fixed price contract with economic price adjustment **shall not be used unless the contracting officer determines that it is necessary to protect the contractor and Government** against significant fluctuations in labor or material costs . . .” [emphasis added]. Paragraph (d)(1) of FAR 16.203-4, “Contract clauses,” outlines when adjustments based on cost indexes of labor and material may be appropriate.

(i) The contract involves an extended period of performance with significant costs to be incurred beyond 1 year after performance begins;

(ii) The contract amount subject to adjustment is substantial; and

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(iii) The economic variables for labor and material are too unstable to permit a reasonable division of risk between the Government and the contractor, without this type of clause.

The Defense Federal Acquisition Regulation Supplement, Procedures, Guidance, and Information 216.203-4, "Contract clauses," cautions contracting officers to carefully craft the economic price adjustment clause and **to always request assistance from their local pricing office (DCMA or DCAA).**

The AMCOM contracting officer did not use an economic price adjustment clause based on an appropriate cost index or request assistance from the local pricing office. Instead, the contracting officer agreed to apply 4 percent annual escalation to contract prices. As shown in Table 21, this decision did not protect Government interests and resulted in excessive prices. We question the decision making and review process of AMCOM contracting officials. The individual who reviewed and approved the price negotiation memorandum with a flat 4 percent escalation was the Principal Assistant Responsible for Contracting. However, because this person no longer works for AMCOM, we will not recommend a review of her performance.

## **Minor Differences Between Costs and Contract Prices**

Out of the 46 parts reviewed, 18 sample parts, valued at \$31.0 million, had minor differences from the negotiated contract price of \$29.7 million. For these 18 parts, AMCOM officials paid \$1.3 million less than the OIG-calculated cost-based price; however, overall Sikorsky technically did not lose money on these parts. Sikorsky applies a [REDACTED] wrap rate to its parts to account for overhead costs and profit. Specifically, Sikorsky's profit, included in the wrap rate, is [REDACTED] percent. For Sikorsky to lose money on these parts, the overall percent difference would have to be more than [REDACTED] percent. For our sample parts, the actual price paid was 4.2 percent lower than the negotiated contract amount for these parts.



Table 22 shows the sample parts that had prices in line with the negotiated contract prices.

**Table 22. Contract Prices Had Minor Differences for 18 Parts**

Sample Number	NSN	Contract Price for Parts Procured	OIG Calculated Price	Difference	
				Amount	Percent
Contract Prices Were Slightly Higher Than Costs					
11	6115011241070	\$2,319,860			
18	1615012259745	1,645,720			
28	1615010745153	5,068,192			
30	3110010854569	1,246,353			
31	1650010957159	2,464,291			
32	1615013575089	971,913			
46	1560011153589	1,218,689			
68	1630010892850	599,035			
71	5977014329247	598,299			
111	1680011138182	353,495			
117	2995011594660	219,390			
121	5340010957378	357,566			
142	1680013837989	157,939			
198	5340013458847	212,367		*	
227	3120013770339	407,673		*	*
Subtotal		\$17,840,783*		*	
Costs Were Higher Than Contract Prices					
2	1615011101491	\$11,455,064		*	
172	5945012129604	354,321		)	
267	3110009323679	31,945			
Subtotal		\$11,841,330		*	
Total		\$29,682,113	\$30,969,160*	(\$1,287,047)	(4.2)
*Slight rounding inconsistencies exist because auditor calculations included decimal places.					

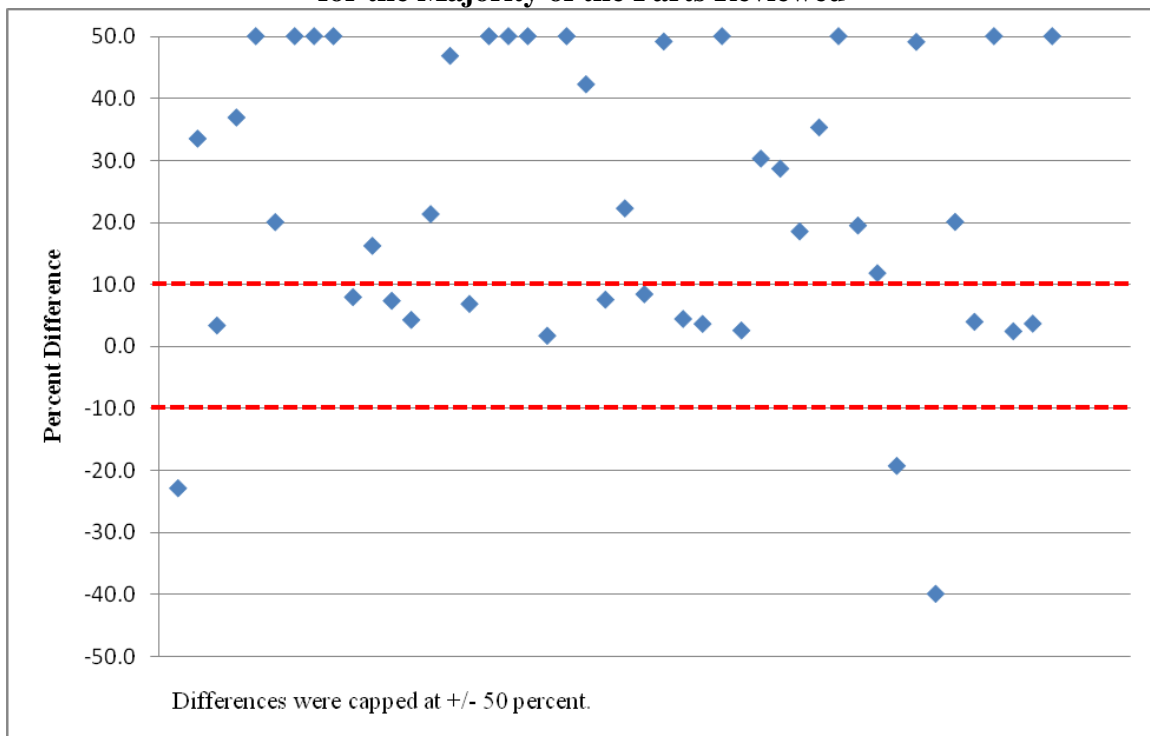
## Better Pricing Controls Are Needed for the Follow-on Contract

AMCOM officials have a myriad of issues to overcome on the CCAD/Sikorsky contract to ensure that prices are fair and reasonable. The escalation applied to contract prices was excessive. Since 2006, DCAA has found significant deficiencies with Sikorsky proposals, including the failure to perform cost or price analysis of subcontractor proposals and to obtain certified cost or pricing data when required. We have identified the same issues reviewing documentation for 46 parts.

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We are concerned that contract prices for 43 of the 46 parts reviewed favored Sikorsky and resulted in excessive profits. We would expect a more balanced variation of increases and decreases from costs than we found in this review. Figure 14 shows that the vast majority of these prices were significantly higher than OIG-calculated cost-based prices and were outside a 10 percent variance.

**Figure 14. Army Contract Prices Were Too High for the Majority of the Parts Reviewed**



Another major concern is that there is an inherent conflict with Sikorsky performing the buying manager role because its profit dollars increase as negotiated costs increase. Also, AMCOM officials seem ill prepared to provide the amount of oversight required to overcome these obstacles and to ensure Sikorsky is effective at negotiating fair and reasonable prices. As a result, AMCOM officials should consider changing the contract type to a fixed-price incentive contract that can better control costs.

DoD IG Report No. D-2011-061, “Excess Inventory and Contracting Pricing Problems Jeopardize the Army Contract With Boeing to Support the Corpus Christi Army Depot,” May 3, 2011, recommended that the Director, Defense Procurement and Acquisition Policy, establish policy showing a clear preference for the use of fixed-price incentive contracts for all contracts exceeding \$100 million (including option years) unless the Government objective price was developed by an experienced cost/price analysis group and also recommended that AMCOM use a fixed-price incentive contract. Therefore, we are not making these recommendations in this report.

However, while we believe the fixed-price incentive may be the best solution to pricing problems, another option would be to develop procedures to annually perform cost analysis on a limited sample of high-risk, high-dollar items to correct pricing before exercising the option year. *AMCOM officials need to perform cost analysis and adjust pricing of a limited sample of high-risk, high-dollar items before exercising the next option or pursue a fixed-price incentive contract.* [Recommendation 2.b(10) – Internal Control] *The Director, Defense Procurement and Acquisition Policy, needs to issue guidance to the contracting workforce that emphasizes performing cost analysis of a limited sample of spare parts before exercising an option under a firm-fixed-price contract.* [Recommendation 3]

## **Management Comments on the Finding and Our Response**

### ***Department of the Army Comments***

The Deputy to the Commanding General, AMCOM, agreed to obtain refunds or demand price reductions when the contractor did not provide full disclosure of data, obvious errors were made, or when the contractor was substantially negligent in establishing the reasonable prices with a supplier. He stated, however, that under a fixed-price contract where a large number of parts are procured, the contractor will negotiate lower prices after the contract agreement, but there will also be parts where the price increases. He stated that the key is whether the overall price and/or quantity changes are substantial enough to warrant a change in either procedures or contract type. The Deputy stated that because this was a performance-based agreement, AMCOM expected material to increase about 25 percent because it was procuring the items through a prime contractor at lower quantities and required rapid turn around. Also, he commented that some of the benefits received were a reduction in repair turn around time and increases in overall production and readiness for the Blackhawk platform. He stated contract improvements would be made, to include a more comprehensive partnership with DLA to require procurement of their inventory, sampling of high-dollar prices annually before exercise of options, and reductions of pass-through costs on material procured through DLA and/or material incentives that allow for sharing of substantial savings due to vendor cost reductions.

### ***Our Response***

We agree that AMCOM should obtain refunds when the contractor provided defective cost data during negotiations and when the contractor failed to perform adequately as AMCOM's procurement manager to obtain fair and reasonable prices. We also recognize the inherent risk in a firm-fixed-price contract. However, our review of costs for the 46 parts shows that prices favored Sikorsky and resulted in excessive profits for 43 of those parts. The excessive prices described in the report have no relationship to the "expected material to increase about 25 percent" stated by the Deputy to the Commanding General. A subsequent report on the CCAD/Sikorsky contract will address other contract concerns.

## **Recommendations, Management Comments, and Our Response**

**1. We recommend that the Director, Defense Contract Management Agency, instruct the Contractor Purchasing Review Division Director to identify the**

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**purchasing system at Sikorsky, Stratford, Connecticut, as high-risk and schedule a purchasing system review to determine whether Sikorsky conducts subcontractor cost or price analyses before prime contract negotiations and whether quantity discounts are being adequately passed on to the Government.**

### ***Defense Contract Management Agency Comments***

The Executive Director, Contracts, DCMA, agreed. The Executive Director stated that DCMA completed a contractor purchasing system review at Sikorsky in January 2011, and deficiencies were noted. The Executive Director stated that DCMA has identified Sikorsky's purchasing systems as high risk, and a contractor purchasing system review is scheduled for February 2012. The review will verify and validate the effectiveness of Sikorsky's corrective actions and address the timing of subcontractor analysis and whether discounts are passed on to the Government.

### ***Our Response***

The Executive Director, Contracts, DCMA, comments are responsive. No further comments are required.

## **2. We recommend that the Commander, Army Aviation and Missile Life Cycle Management Command:**

**a. Develop procedures to ensure that contracting officers or other oversight officials perform adequate price analysis in conjunction with cost analysis to determine price reasonableness, obtain adequate support for large price increases, and ensure that multi-tier subcontractor prices are adequately evaluated.**

### ***Department of the Army Comments***

The Deputy to the Commanding General, AMCOM, agreed. He stated that the contracting officer used DCAA and DCMA in performing cost or price analysis for the Sikorsky proposal of about 7,000 parts. He also stated the contracting officer relied on certified cost or pricing data in determining fair and reasonable prices and DCMA reviewed about 80 percent of the total dollars of the bills of material, using vendor quotes, cost or price analysis provided by the contractor, and purchase history. The Deputy stated that AMCOM recognizes the need to focus on the evaluation of proposals and drive efficiencies in large-dollar acquisitions, so the Army Contracting Command-Redstone Arsenal has established a new directorate of cost/price analysts. He stated that training is being conducted as the new directorate stands up and with increased growth the directorate will provide improved focus in evaluation and pricing of negotiated procurements.

### ***Our Response***

The Deputy to the Commanding General, AMCOM, comments are responsive. No further comments are required.

**b. Instruct the contracting officer to:**

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**(1) Obtain Sikorsky refunds of about \$1.5 million for NSNs 1680-01-380-3819, 5975-01-424-3604, 6220-01-306-8980, and 1615-01-221-2603, which were priced with defective data or an unacceptable quantity curve, and correct prices to avoid excessive profits totaling about \$2.0 million for contract years 2011 and 2012.**

### ***Department of the Army Comments***

The Deputy to the Commanding General, AMCOM, partially agreed. The Deputy stated that the recommendations for refunds were based on 28 of the 46 items reviewed. Further, he stated that the 28 items reflected 13 percent of the total material sold under the audited contracts from 2008 through June 2011. He also stated that Sikorsky reviewed their pricing data and determined there were pricing errors for NSNs 1680-01-380-3819, 5975-01-424-3604, and 6220-01-306-8980. He stated that Sikorsky submitted voluntary refund proposals for these items, which the contracting officer is currently reviewing. For NSN 1615-01-221-2603, the Deputy stated that Sikorsky data indicates that Sikorsky reviewed the pricing from Derco, to reduce the [REDACTED] price. For instance, Derco asked [REDACTED] why it sold the items directly to the Government for one price and to Derco for another price on contracts for the Government. He stated that [REDACTED] explained that its price was based on commercial pricing and that it priced the “worst case scenario” because of a history of canceled orders. He stated that Sikorsky’s documentation also showed that all parties were aware of the DLA-negotiated price and tried to negotiate a lower price. The Deputy stated that the rotors would be purchased from DLA inventory if it is available.

### ***Our Response***

The Deputy to the Commanding General, AMCOM, comments are partially responsive. We agree that Sikorsky should fix prices and issue refunds for excessive prices charged, plus applicable penalties and interest, when defective cost or pricing data are used to negotiate prices.

However, we disagree with AMCOM’s position of not seeking a refund for NSN 1615-01-221-2603, rotor. As detailed in the report, the rotor pricing was based on an unacceptable quantity curve [REDACTED] when AMCOM’s actual usage was about 40 annually. We question the decision to pay unreasonable commercial prices, when “all parties” were aware that DLA had a much lower price for the rotor.

In addition, although we recognize that AMCOM is trying to meet the intent of the recommendation by obtaining future requirements from DLA at a much lower price, current DLA inventory of 34 rotors will not satisfy 1 year’s requirement. We expect that AMCOM will communicate its future needs to ensure that DLA will have the inventory required to satisfy future requirements. We request additional comments in response to the report, which detail AMCOM’s plan to satisfy future requirements using DLA inventory and pricing, as well as its efforts to obtain a refund for the rotor.

**(2) Obtain Sikorsky refunds of \$219,371 for 25 Derco Aerospace parts and correct the 2011 and 2012 contract unit prices.**

***Department of the Army Comments***

The Deputy to the Commanding General, AMCOM, agreed. He stated that the refund proposal is being reviewed by the contracting officer and appropriate action will be taken as required.

***Our Response***

The Deputy to the Commanding General, AMCOM, comments are responsive. No further comments are required.

**(3) Procure or have Sikorsky procure NSN 1615-01-221-2603 from DLA Aviation to save about \$1.3 million over the next 2 years based on planned contract quantities.**

***Department of the Army***

The Deputy to the Commanding General, AMCOM, agreed. He stated that for the remainder of the contract this NSN will be purchased from DLA if inventory is available.

***Our Response***

The Deputy to the Commanding General, AMCOM, comments are partially responsive. As discussed in our response to 2.b(1), we recognize that AMCOM is trying to meet the intent of the recommendation by obtaining future requirements from DLA at a much lower price. However, current DLA inventory of 34 rotors will not satisfy 1 year's requirement. We expect that AMCOM will communicate its future needs to ensure that DLA will have the inventory required to satisfy future requirements. We request additional comments in response to the report, which detail AMCOM's plan to satisfy future requirements using DLA inventory and its much lower price for the rotor.

**(4) Obtain refunds of about \$7.0 million from Sikorsky for unnecessary pass-through costs and correct prices to avoid excessive profits of about \$10.4 million for NSNs 1615-01-390-0740, 1560-01-186-7122, 1560-01-125-9937, 1560-01-125-9938, and 1560-01-115-3667.**

***Department of the Army Comments***

The Deputy to the Commanding General, AMCOM, partially agreed. He disagreed with obtaining refunds, but did agree on reducing prices before the exercise of the next option year. For NSN 1615-01-390-0740, the Deputy stated that Sikorsky performed a cost analysis on a [REDACTED]

[REDACTED] He stated this is a common Sikorsky practice for suppliers with large quantities of items and savings achieved through these types of negotiations are passed to the Government through both production and spares contracts. The Deputy stated that the contractor assumes the risk for price increases in a firm-fixed-price environment. He noted that the raw material price from [REDACTED] was in line with the market

and that if the price had increased, [REDACTED] would not have been able to increase its price to Sikorsky. He stated that the OIG's assertion, that Sikorsky had no risk of loss due to significant changes to the price of titanium in the [REDACTED], does not appear to be supported based on Sikorsky documentation. He stated that the agreement obligates Sikorsky to purchase a minimum of [REDACTED] of the blades in the forecast quantity in the year of delivery. Should Sikorsky fail to purchase [REDACTED] of the forecasted quantity in any year, it is required to immediately purchase the excess quantity of titanium, which places substantial cost risk on Sikorsky.

For [REDACTED] items (NSNs 1560-01-186-7122, 1560-01-125-9937, 1560-01-125-9938, and 1560-01-115-3667), the Deputy stated that a cost or price analysis was completed on 1,200 parts, [REDACTED]

[REDACTED] The Deputy stated that based on a review of the individual parts, the contracting officer would request that Sikorsky adjust pricing to be more in line with the vendor pricing.

### ***Our Response***

The Deputy to the Commanding General, AMCOM, comments are partially responsive. We disagree with the AMCOM position of not seeking refunds of \$7 million for the excessive prices paid through 2010. In addition, the comments provided do not address pricing of the items for 2011.

We do not see any savings related to the prices of NSN 1615-01-390-0740, titanium blade sheath assembly, [REDACTED] The [REDACTED] fixed Sikorsky's costs at [REDACTED] resulting in a CCAD/Sikorsky contract price of \$17,004.39 to \$19,891.98 over the course of the contract. Previously the Army acquired the titanium blade sheath assembly for \$7,936.57 (a difference of 114.3 to 150.6 percent) each in 2007. As detailed in the report, pursuant to FAR 15.404-3, "Subcontract Pricing Considerations," an adequate cost analysis of each supplier's certified proposal should have been conducted by either Sikorsky or the contracting officer. Our audit detailed that only [REDACTED] and Sikorsky certified to its cost data, while [REDACTED] did not provide cost data, only prices. After we performed cost analysis of each supplier costs, we determined that a reasonable price for the titanium blade sheath assembly should be \$11,844.39. As a result of not having all the subcontract proposals properly analyzed, the Army paid excessive prices of \$6.6 million through 2010 for NSN 1615-01-390-0740.

In addition, we disagree with the Deputy that there is a substantial cost risk to Sikorsky caused by the [REDACTED]

[REDACTED] We acknowledge that Sikorsky may need to provide additional investment in material if demands are significantly lower; however, Sikorsky has no risk of loss because they have both military and commercial customers for helicopters and can roll over quantities not purchased to future years.

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We agree that the prices of spare parts from [REDACTED] were accepted as proposed by Sikorsky, resulting in AMCOM paying excessive prices.

Given that Sikorsky did not perform adequately as AMCOM's procurement manager by failing to obtain and review cost data and negotiating fair and reasonable prices from its suppliers, Sikorsky bears responsibility to refund the excessive prices paid. We request that the Deputy to the Commanding General, AMCOM, reconsider his position and provide additional comments in response to the report, which address the efforts to obtain refunds and lower prices for these items when adequate subcontract cost analysis was not performed by Sikorsky.

**(5) Consider using an economic price adjustment clause in the follow-on contract unless acceptable long-term prices for titanium can be negotiated.**

### ***Department of the Army Comments***

The Deputy to the Commanding General, AMCOM, agreed. He stated that if titanium prices are in a state of significant fluctuation, an economic price adjustment clause will be incorporated into the follow-on contract.

### ***Our Response***

The Deputy to the Commanding General, AMCOM, comments are responsive. No further comments are required.

**(6) Request a refund of about \$3.3 million from Sikorsky and correct contract prices for 2011 and 2012 to avoid excessive profits totaling about \$4.2 million for which lower prices were negotiated with suppliers shortly after prices were negotiated with the Army.**

### ***Department of the Army Comments***

The Deputy to the Commanding General, AMCOM, partially agreed. He stated that the Government assumes that contractors' proposals are based on economic order quantities. The Deputy stated that once negotiations have concluded and the contractor's pricing is based on accurate and complete data at certification, the contractor has met the requirements for cost and pricing certification even if its negotiates lower prices after certification. He stated that this is a common industry practice and part of doing business, as adjustments are made from quotes to purchase orders. The Deputy stated that Sikorsky has a disciplined process for a board at the vice president level to review make/buy items. He stated that the board considers capacity and demand, and ensures that a qualified vendor can support production with a quality part. He also commented on the pricing of each spare part we identified in this category and generally agreed to seek lower pricing from Sikorsky or DLA.

## Our Response

The Deputy to the Commanding General, AMCOM, comments are partially responsive. We found a recurring problem of Sikorsky negotiating lower prices with its supplier after completing negotiations with AMCOM. AMCOM needs to be aware of this inherent risk using long-term, firm-fixed-price contracts and take appropriate steps to share in reduced prices from Sikorsky's suppliers. AMCOM actions to lower prices by obtaining the items from DLA or reducing current contract prices are a step in the right direction. For more detail on each of the parts discussed, please refer to the report's finding. In regard to the difficulty in obtaining reasonable prices from Honeywell, a more effective approach may be for AMCOM to work with DLA to negotiate or obtain cost-based prices using the DLA/Honeywell long-term contract. Table 23 shows that both the Army and DLA negotiated much lower prices from Honeywell than Sikorsky did.

**Table 23. The Army and DLA Negotiated Much Lower Prices From Honeywell Than Sikorsky Did**

Sample Number	NSN	Order Date	Previous Contract Unit Price <sup>1</sup>	CCAD/Sikorsky Contract 2010 Unit Price	Percent Difference
65	6115011456875	10/2003	\$4,237.82	\$10,371.25	144.7
104	6115011177281	3/2006	5,799.00	9,651.27	66.4
156	6115011177238	10/2004	6,319.72	13,582.48	114.9
228 <sup>2</sup>	3110011055802	4/2009	86.46	274.44	217.4
285	5998011451798	11/2006	1,266.58	5,609.34	342.9
<sup>1</sup> Previous contract unit prices were adjusted as of October 2009 using the BLS producer price index (PPI) for aircraft parts.					
<sup>2</sup> This part is on the cost-based DLA-Honeywell long-term contract.					

In addition, our recommendation to perform cost analysis and adjust pricing of a limited sample of high-risk, high-dollar items before exercising the next option or pursue a fixed-price incentive contract [Recommendation 2.b(10)] was designed to address this issue. The Deputy's agreement to implement a review of pricing each option year meets the intent of this recommendation; therefore, no further comments are required.

**(7) Request a voluntary refund of about \$5.4 million from Sikorsky for profits caused by excessive escalation from 2008 through 2010.**

## Department of the Army Comments

The Deputy to the Commanding General, AMCOM, partially agreed. He stated that the contracting officer negotiated the escalation factor based on the known market conditions and the buying office substantiated that the resulting escalation factor was reasonable for the out years. The Deputy stated that during the proposal evaluation Sikorsky provided information from Global Insight Producer Price Index for Aircraft and Parts from 2005 to 2007, which reflected an average of 3.9 percent and escalation was forecasted to be 3.1 percent in 2008 and 1.8 percent in 2009. [REDACTED]

[REDACTED]. The Deputy also stated that according to Sikorsky officials the forecasted escalation rates were based on a decrease in energy costs and that energy costs actually increased significantly in 2008. [REDACTED]

[REDACTED]. The Deputy stated that a review was performed of Sikorsky's actual escalation in 2008, 2009, and 2010 and found that subcontract escalation was [REDACTED] from 2008 to 2009 and [REDACTED] from 2009 to 2010.

### ***Our Response***

The Deputy to the Commanding General, AMCOM, comments are partially responsive. While his comments failed to specifically address pursuing a refund, the comments detail that AMCOM reviewed information related to labor and material costs to review the effectiveness of the escalation factor. Again, contract escalation is added to protect both the contractor and Government from significant fluctuations in labor and material costs. It is not intended to create excessive profits or promote inefficiency. As our report shows, AMCOM needs to base contract escalation on an appropriate economic index rather than a flat yearly percentage to better control the reasonableness of contract prices. Also, Sikorsky purchase history obtained during our review does not match the amount of subcontract escalation claimed in the Deputy's comments. [REDACTED]

[REDACTED]. In addition, Sikorsky cost or price analyses we obtained considered escalation for their supplier base at [REDACTED] annually. For example, the titanium blade sheath assembly had a fixed supplier price of [REDACTED] from January 2008 through December 2012. Sikorsky signed the price agreement with its suppliers in October 2007, well before the material certification date and also before negotiations of contract escalation occurred. To date, using the actual quantities purchased, we calculate that AMCOM has paid \$751,892 in excessive profits for the titanium blade sheath assembly due to escalation. AMCOM needs to pursue a refund for the titanium blade sheath assembly and other high-dollar parts where [REDACTED] was applied to Sikorsky's supplier price. We request that the Deputy to the Commanding General, AMCOM, reconsider his position and provide additional comments in response to the report, which address the efforts to obtain refunds for obvious pricing problems.

**(8) Account for and request a refund from Sikorsky for excessive escalation for 2011.**

### ***Department of the Army Comments***

The Deputy to the Commanding General, AMCOM, partially agreed. He stated the contract will be reviewed to assess escalation projections for the remaining period of performance of the contract.

### ***Our Response***

The Deputy to the Commanding General, AMCOM, comments are partially responsive. Although he stated that AMCOM will review escalation projections, the comments failed

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to address whether AMCOM will account for excessive prices paid and obtain reduced pricing for 2011. We request additional comments in response to the report, which address how prices for 2011 will be reduced or a refund will be obtained.

**(9) Modify the contract to base contract escalation on an appropriate economic index and correct prices to avoid excessive prices of \$8.7 million in 2012, before exercising the next option year.**

### ***Department of the Army Comments***

The Deputy to the Commanding General, AMCOM, agreed. He stated that for 2012, AMCOM will negotiate with Sikorsky to achieve a reduced escalation based on the current market conditions and 2012 prices will reflect this reduction.

### ***Our Response***

The Deputy to the Commanding General, AMCOM, comments are partially responsive. However, the approach of merely reducing the escalation percent in 2012 will not fully correct contract prices. As detailed in our report, the contract prices that were based on the flat 4 percent escalation were overstated when compared with actual costs and should be properly reduced. For example, the titanium blade sheath assembly price, as discussed in our response to Recommendation 2.b(7), needs to be corrected based on Sikorsky's actual costs, [REDACTED]. We calculate that if this price is corrected, AMCOM will save about \$3.3 million in excessive prices based on planned contract quantities in 2011 and 2012. We request additional comments in response to the final report discussing how prices for 2012 will be corrected.

**(10) Perform cost analysis and adjust pricing of a limited sample of high-risk, high-dollar items before exercising the next option or pursue a fixed-price incentive contract.**

### ***Department of the Army Comments***

The Deputy to the Commanding General, AMCOM, agreed. He stated that a sample of high-risk, high-dollar items will be reviewed via cost analysis before exercising the next option.

### ***Our Response***

The Deputy to the Commanding General, AMCOM, comments are responsive. No further comments are required.

**3. We recommend that the Director, Defense Procurement and Acquisition Policy, issue guidance to the contracting workforce that emphasizes performing cost analysis of a limited sample of spare parts before exercising an option under a firm-fixed-price contract.**

### ***Defense Procurement and Acquisition Policy Comments***

The Director, Defense Procurement and Acquisition Policy, agreed. He stated that the Director of Defense Pricing will issue a policy memorandum advising the acquisition community to perform cost and price analysis on a sample of spare parts before exercising an option under a firm-fixed-price contract.

### ***Our Response***

The Director, Defense Procurement and Acquisition Policy, comments are responsive. No further comments are required.

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## **Appendix A. Scope and Methodology**

We conducted this performance audit from November 2009 through May 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

### **Interviews and Documentation**

We met with the Commander, CCAD, and the Director, Support Operations, AMC. We interviewed and obtained cost support documentation from personnel at Sikorsky, Derco Aerospace, [REDACTED] and DCMA, Sikorsky. We interviewed and obtained acquisition planning documentation from personnel of the AMCOM Contracting Center, Redstone Arsenal, Alabama. In addition, we interviewed and obtained documentation from Sikorsky personnel in Stratford, Connecticut. We reviewed the United States Code, FAR, and DFARS for guidance on acquisition planning, contract pricing, and inventory. We used the Electronic Documentation Access System to obtain and review the current CCAD/Sikorsky contract W58RGZ-09-D-0029 and modifications issued from December 2008 through December 2010. We reviewed the escalation applied to contract prices in the AMCOM contract with Sikorsky. We reviewed the Defense Financial Accounting Service disbursement data to determine the dollars of material purchased from 2008 through 2010. We applied the simple average of material purchased for 2008 through 2010 as the material amounts for 2011 and 2012. We used the BLS producer price index for other aircraft parts and equipment from 2008 through 2010. We also interviewed a Senior Cost/Price Analyst from the Air Force and used his rational projections for 2011 and 2012 escalation in our calculations.

### **Nonstatistical Sample Selection**

We selected a sample of 332 parts based on the top 80 percent of the total contract value, which was selected from both the components and airframe material for contract W58RGZ-09-D-0029. The sample parts represented \$496.1 million of the total \$619.9 million of material on the contract.

### **Price Analysis**

We obtained prior procurement history from Haystacks and DLA standard unit prices from the DLA Office of Resource and Research Analysis for the DLA-managed items. We used the Electronic Document Access System to identify prior acquisition prices for the Army-managed items. We compared the current contract unit price and quantity with previous procurements for Army-managed parts and the DLA standard unit prices with DLA-managed items to determine the price increase.

## Cost Analysis

We obtained and reviewed information other than cost or pricing data for 51 items from Sikorsky and [REDACTED] of its subcontractors: [REDACTED]. We selected the items based on significant price discrepancies from the previous procurement or DLA standard unit price. We also considered significant quantity differences in our selection. We selected five parts that did not have a procurement history, but had a significant contract value. However, these five items were removed from our analysis because we did not have procurement history to make a valid comparison. We performed cost analysis on 46 items to determine whether the Government was paying fair and reasonable prices for these items. We added the negotiated contract profit and contractor burdens to the contractor costs to calculate a cost-based price when performing our analysis.

## Use of Computer-Processed Data

We relied on computer-processed data from DoD, DLA, and commercial sources. We used data from the Electronic Document Access System to identify previous procurement quantities and prices of the sample items. We also obtained the procurement history for the sample items from Haystacks, a commercial system. We obtained data from the DLA Office of Resource and Research Analysis to include inventory, demand, and pricing data. The computer-processed data and procurement history data were determined reliable based on a comparison with actual source documents. In addition, we have used Haystacks for the past several audits and have not found any material errors or discrepancies. We did not find errors that would preclude the use of the computer-processed data to meet the audit objectives or that would change the conclusions reached in this report.

## Prior Coverage

During the last 5 years, the Government Accountability Office (GAO), the Department of Defense Inspector General (DoD IG), and the Army Audit Agency have issued nine reports discussing topics related to the management of spare part inventories and DoD public-private partnership agreements with private firms for depot maintenance. Unrestricted GAO reports can be accessed over the Internet at <http://www.gao.gov>. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/audit/reports>.

## GAO

GAO Report No. GAO-11-139, "Additional Oversight and Reporting for the Army Logistics Modernization Program Are Needed," November 18, 2010

GAO Report No. GAO-10-469, "Defense Logistics Agency Needs to Expand on Efforts to More Effectively Manage Spare Parts," May 11, 2010

GAO Report No. GAO-10-461, "Actions Needed to Improve Implementation of the Army Logistics Modernization Program," April 30, 2010



GAO Report No. GAO-09-703, "DoD Needs to Update Savings Estimates and Continue to Address Challenges in Consolidating Supply-Related Functions at Depot Maintenance Locations," July 9, 2009

GAO Report No. GAO-08-902R, "Depot Maintenance: DoD's Report to Congress on Its Public-Private Partnerships at Its Centers of Industrial and Technical Excellence (CITEs) Is Not Complete and Additional Information Would Be Useful," July 1, 2008

***DoD IG***

DoD IG Report D-2011-061, "Excess Inventory and Contracting Pricing Problems Jeopardize the Army Contract With Boeing to Support the Corpus Christi Army Depot," May 3, 2011

DoD IG Report No. D-2010-067, "Public-Private Partnerships at Air Force Maintenance Depots," June 10, 2010

DoD IG Report No. D-2010-063, "Analysis of Air Force Secondary Power Logistics Solution Contract," May 21, 2010

***Army Audit Agency***

Army Audit Agency Report No. A-2008-0058-ALM, "Benefits of Public-Private Partnerships," February 7, 2008

## Appendix B. Comparison of 2010 Contract and OIG-Calculated Unit Prices

Sample	NSN	Part Name	2010 Unit Price		Percent Difference <sup>1</sup>
			Contract	OIG	
1	1615013900740	Titanium Blade Sheath	\$18,391.26	\$11,844.39	55.3
2	1615011101491	Main Housing Assembly	41,241.69		
8	3040014158388	Shaft Assembly	25,758.73		
11	6115011241070	Rotor Generator	11,821.84		
12	3040010957220	Center Housing Assembly	12,548.19		
18	1615012259745	Stator	15,639.07		
28	1615010745153	Plate Assembly	16,423.35		
29	3020011391321	Pinion	6,073.48		
30	3110010854569	Bearing	3,189.31		
31	1650010957159	Hydraulic Amplifier	3,267.34		
32	1615013575089	Swash Plate Assembly	19,148.97		
34	1615011342507	Housing Assembly	6,005.15		
36	1615012212603	Rotor	7,514.31	2,378.77 <sup>2</sup>	215.9
44	1615013764398	Housing Assembly	6,039.91		
46	1560011153589	Window Panel, Aircraft	3,819.72		
65	6115011456875	End Bell Assembly	10,371.25		
66	5320014560634	Pin Rivet	19.84		
68	1630010892850	Brake, Multiple Disk	3,709.97		
71	5977014329247	Ring Assembly, Electric	18,503.02		
79	1680013803819	Belt, Aircraft Safety	2,959.57		
83	3040013686667	Flange	3,838.00		
104	6115011177281	Stator Generator	9,651.27		
109	5320014561475	Pin Rivet	13.27		
111	1680011138182	Cover, Seat	514.60		
113	3120010906519	Bearing Assembly	578.61		
117	2995011594660	Valve	10,720.68		
121	5340010957378	Fairing Assembly	260.82		
134	1560011735845	Cover, Access	709.48		

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Sample	NSN	Part Name	2010 Unit Price		Percent Difference <sup>1</sup>
			Contract	OIG	
142	1680013837989	Belt, Aircraft	2,746.41	████████	████
156	6115011177238	Rotor Generator	13,582.48	████████	████
172	5945012129604	Solenoid Assembly, Second	370.65	████████	████
175	1615011026051	Bracket	107.38	████████	████
198	5340013458847	Button	38.65	████████	████
227	3120013770339	Bearing	506.47	████████	████
228	3110011055802	Ball Bearing	274.44	████████	████
234	1560011867122	Panel, Structural, Aircraft	2,332.86	████████	████
248	5975014243604	Cover, Junction Box	2,393.41	████████	████
255	1680012737591	Lateral Output Lever Assembly	1,941.18	████████	████
258	1560011259938	Door, Access, Aircraft	2,498.38	████████	████
263	6220013068980	Panel, Indicating ,Light	3,778.74	████████	████
267	3110009323679	Bearing	685.76	████████	████
285	5998011451798	Printed Circuit Board Assembly	5,609.34	████████	████
288	3040012893594	Shaft	15,322.51	████████	████
293	1560011259937	Door, Access, Aircraft	2,421.99	████████	████
330	5340011014086	Ring, Door, Flush	284.46	████████	████
332	1560011153667	Panel Assembly, Ceiling	1,457.15	████████	████
<sup>1</sup> The percent difference may vary slightly from the calculations used in the finding because those calculations were weighted averages.					
<sup>2</sup> We used the DLA standard unit price in our calculations of excessive profit for one item because an unacceptable quantity curve ██████████ was used to establish the basis of the contract price.					

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# Defense Procurement and Acquisition Policy Comments



ACQUISITION,  
TECHNOLOGY  
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE  
3000 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3000

JUL 26 2011

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL, ACQUISITION &  
CONTRACT MANAGEMENT

THROUGH: DIRECTOR, ACQUISITION RESOURCES AND ANALYSIS

W8  
7/27/11

SUBJECT: Response to DoDIG Draft Report - Pricing and Escalation Issues Weaken the  
Effectiveness of the Army Contract with Sikorsky to Support the Corpus Christi  
Army Depot (Project No. D2010-D000CH-0077.001)

As requested, I am providing responses to the general content and recommendations  
contained in the subject report.

**Recommendation [3]:**

We recommend that the Director, Defense Procurement and Acquisition Policy (DPAP), issue  
guidance to the contracting workforce that emphasizes performing cost analysis of a limited  
sample of spare parts before exercising an option under a firm-fixed-price contract.

**Response:**

Concur. The Director of Defense Pricing will issue a policy memorandum advising the  
acquisition community to perform cost and price analysis on a sample of spare parts before  
exercising an option under a firm-fixed-price contract.

Please contact [REDACTED] if additional  
information is required.

  
Richard Ginman  
Director, Defense Procurement  
and Acquisition Policy

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# Department of the Army Comments



REPLY TO  
ATTENTION OF:

DEPARTMENT OF THE ARMY  
HEADQUARTERS, U.S. ARMY MATERIEL COMMAND  
4400 MARTIN ROAD  
REDSTONE ARSENAL, AL 35898-5000

AMCIR

JUL 22 2011

MEMORANDUM FOR Department of Defense Inspector General (DoDIG), ATTN: [REDACTED]  
[REDACTED] Room 300, 400 Army Navy Drive, Arlington, VA 22202-4704

SUBJECT: Command Reply to Draft Report: Pricing and Escalation Issues Weaken the Effectiveness of the Army Contract With Sikorsky to Support the Corpus Christi Army Depot (Project Number: D2010-D000CH-0077.001) (D1011)

1. The U.S. Army Materiel Command (AMC) has reviewed the subject report and the response provided by the U.S. Army Aviation and Missile Command (AMCOM) written in collaboration with the U.S. Army Contracting Command (ACC), ACC-Redstone Contracting Center. AMC endorses the response from AMCOM and ACC.

2. The AMC point of contact is [REDACTED]  
[REDACTED]

Encl

JOHN B. NERGER  
Executive Deputy to the  
Commanding General

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REPLY TO  
ATTENTION OF:

DEPARTMENT OF THE ARMY  
U.S. ARMY CONTRACTING COMMAND  
3334A WELLS ROAD  
REDSTONE ARSENAL, AL 35898-5000

JUL 19 2011

AMSCC-IR


MEMORANDUM FOR [REDACTED] Acting Director, Internal Review and Audit  
Compliance Office, Headquarters, U.S. Army Materiel Command, 4400 Martin Road, Redstone  
Arsenal, AL 35898

SUBJECT: DODIG Draft Report, Pricing and Escalation Issues Weaken the Effectiveness of the  
Army Contract with Sikorsky to Support the Corpus Christi Army Depot (Project No. D2010-  
D000CH-0077.001) (D7000)

1. Reference memorandum and draft report, Department of Defense Inspector General,  
2 June 2011, subject: Pricing and Escalation Issues Weaken the Effectiveness of the Army  
Contract with Sikorsky to Support the Corpus Christi Army Depot (Project No. D2010-D000CH-  
0077.001)
2. The Army Contracting Command (ACC) response to the referenced documents is enclosed.
3. The ACC point of contact is [REDACTED]

Encl

  
JEFFREY P. PARSONS  
Executive Director

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DEPARTMENT OF THE ARMY  
UNITED STATES ARMY AVIATION AND MISSILE COMMAND  
5300 MARTIN ROAD  
REDSTONE ARSENAL AL 35898-5000

AMSAM-IR

JUL 7 2011

MEMORANDUM THRU [REDACTED] Acting Director, Internal Review and Audit  
Compliance Office, US Army Materiel Command, Building 4400, Martin Road, Redstone  
Arsenal, AL 35898-5000

FOR Department of Defense, [REDACTED] Office of Inspector General, 400 Army  
Navy Drive, Arlington, VA 22202-4704

SUBJECT: DODIG Draft Report, Pricing and Escalation Issues Weaken the Effectiveness of the  
Army Contract With Sikorsky to Support the Corpus Christi Army Depot (Project No. D2010-  
D000CH-0077.001) (AMC D1011) (AMCOM No. 2010L009D)

1. Reference HQ AMC Tasker A1-SGS.4-1158-7000, 7 Jun 11, SAB.
2. Enclosed are comments to the subject draft report from the US Army Aviation and Missile  
Life Cycle Management Command (AMCOM). The report was reviewed and comments  
provided by AMCOM Integrated Materiel Management Center, Corpus Christi Army Depot, and  
Army Contracting Command – Redstone.
3. The point of contact is [REDACTED]

Encl

RONALD E. CHRONISTER  
Deputy to the Commanding General



**COMMAND COMMENTS**  
**DODIG Draft Report**  
**Pricing and Escalation Issues Weaken the Effectiveness of the**  
**Army Contract With Sikorsky to Support the**  
**Corpus Christi Army Depot**  
**(Project No. D2010-D000CH-0077.001)**  
**(AMC No. D1011) (AMCOM No. 2010L009D)**

**Finding. Spare Parts Pricing Problems:**

“AMCOM officials did not effectively negotiate fair and reasonable prices for noncompetitive spare parts procured on the CCAD/Sikorsky contract. We reviewed costs for 46 high-dollar parts valued at about \$64.4 million and identified pricing problems with 28 of the parts valued at about \$34.7 million. These pricing problems occurred because neither Sikorsky nor AMCOM officials performed adequate cost or price analyses<sup>3</sup> of proposed subcontractor prices that were used to support negotiated prices. The pricing problems also occurred because Sikorsky officials proposed, and AMCOM officials accepted, questionable cost or pricing data that had no relationship to the actual price Sikorsky negotiated with its subcontractors. Specific problems include:

- Sikorsky furnished certified cost or pricing data that were not current, complete, and accurate at the time of the material certification cutoff date (3 parts) and used an unacceptable quantity curve from [REDACTED] in determining the cost basis (1 part).
- Sikorsky accepted unreasonable price increases from subcontractors resulting in excessive pass-through costs (5 parts).
- Sikorsky consistently negotiated lower firm prices with suppliers after prices were agreed to with AMCOM and also proposed prices based on significantly lower quantities than it purchased (19 parts).

As a result, we calculated that Sikorsky charged the Army \$11.8 million (51.4 percent) more than fair and reasonable prices (\$34.7 million versus \$22.9 million) for 28 parts through November 2010. If prices are not corrected, AMCOM officials will pay excessive profits of approximately \$16.6 million over the remaining 2 years of the CCAD/Sikorsky contract. During the audit, Sikorsky proposed refunds of about \$1.0 million to address pricing problems. Contract prices for 18 parts (15 higher and 3 lower), valued at \$29.7 million, had minor differences (\$1.3 million less) from cost-based prices of \$31.0 million. In addition, through 2010, we calculated that AMCOM paid \$5.4 million more than necessary due to excessive contract escalation rates that were not tied to an economic index and that AMCOM will pay excessive prices of about \$15.6 million (\$6.9 million in 2011 and \$8.7 million in 2012) over the remaining 2 years of the contract if not corrected.”

**Recommendation 2:** "We recommend that the Commander, Army Aviation and Missile Life Cycle Management Command:

a. Develop procedures to ensure that contracting officers or other oversight officials perform adequate price analysis in conjunction with cost analysis to determine price reasonableness, obtain adequate support for large price increases, and ensure that multi-tier subcontractor prices are adequately evaluated."

**Command Comments:** Concur. The ACC-Redstone Contracting Officer utilized DCAA and DCMA in performing cost/price analysis for the Sikorsky proposal of technical, engineering and logistics support to include providing material for approximately 7,000 parts. The Contracting Officer relied on certified cost and pricing data submitted by the contractor in determining fair and reasonable prices. DCMA reviewed approximately 80 percent of the total dollars of the bills of material, utilizing vendor quotes, cost/price analysis provided by the contractor, and purchase history. Recognizing the need to focus on the evaluation of proposals and drive efficiencies in our large dollar acquisitions, ACC-Redstone has established a new Directorate of cost/price analysts. Significant training within the price analyst field is being conducted as the new Directorate stands-up. This Directorate, in conjunction with the increased growth in DCMA within the cost/price area, will provide improved focus in evaluation and pricing of our negotiated procurements.

b. "Instruct the contracting officer to:

(1) Obtain Sikorsky refunds of about \$1.5M for NSN 1680-01-380-3819, 5975-01-424-3604, 6220-01-306-8980, and 1615-01-221-2603, which were priced with defective data or an unacceptable quantity curve, and correct prices to avoid excessive profits totaling about \$2.0 million for contract years 2011 and 2012."

**Command Comments:** Partially Concur. The DoDIG report indicated that their recommendations relative to refunds were based on 28 items (originally beginning with a sample set of 46). These 28 items reflect 13% of the total material sold under the IG audited Sikorsky contracts from 2008 through June 2011. Sikorsky reviewed their pricing data relative to items cited above and determined that errors were made in pricing NSNs 1680-01-380-3819, Aircraft Safety Belt, 5975-01-424-3604, Junction Box, and 6220-01-306-8980, Indicating Light Panel. Sikorsky has submitted voluntary refund proposals that are currently in review by the contracting officer. The current individual item proposal refund amounts are Indicating Light, \$167,248.29, Safety Belt, \$317,178.25, and Junction Box, \$128,414.63. There is also a refund proposal under review for 25 items provided by Derco (a subsidiary of Sikorsky) in the amount of \$219,371. Additionally, at the request of the contracting officer, DCAA is currently performing a post award audit on the contracts cited in this IG report. Any findings resulting from the DCAA review will be addressed.

For NSN 1615-01-221-2603, Rotor, a review of Sikorsky data indicates that Sikorsky reviewed the pricing from their subcontractor, Derco, and discussed it in great detail in an

attempt to reduce the [REDACTED] proposed unit price. Documentation of discussions between DCMA and Sikorsky indicates that on 2 April 2008, Derco sent a request for explanation to [REDACTED] "as to why" [REDACTED] sold to the USG direct for one price (in 2007) and are selling to Derco at another price, which is going to the USG as well. Later that day, [REDACTED] answered "Our pricing to Derco is based on commercial pricing practices as is common with our distributors and will remain as our quote." Research also indicates that the [REDACTED] pricing is quantity sensitive and that [REDACTED] priced the "worst case scenario."

On 7 April 2008, Derco sent a detailed follow-up request for clarification as to the application of [REDACTED] "aftermarket/commercial pricing." In a letter dated 25 April 2008, [REDACTED] responded to Derco with the information stated in the IG report, as follows:

[REDACTED]

A review of Sikorsky detailed documentation of the evaluation of this price, indicates that all parties were aware of the DLA negotiated price with [REDACTED] and discussed it in great detail attempting to obtain the reduced DLA pricing under this contract. The documentation shows that Derco repeatedly contacted [REDACTED] to obtain a better price. Clearly, [REDACTED] would only reduce pricing below the [REDACTED] if Derco agreed to guarantee to purchase minimum quantities of rotors and that [REDACTED] pricing was based on "worst case scenario" due to the history of cancellation of orders when CCAD did not purchase. The risks to guarantee minimum quantities could not be substantiated given the dynamic depot workload forecasts as well as funding restrictions of the contract.

However, fully recognizing the above comments, the rotor quantities required for the remainder of the contract will be purchased from DLA quantities as available.

(2) "Obtain Sikorsky refunds of \$219,371 for 25 Derco Aerospace parts and correct the 2011 and 2012 contract unit prices."

**Command Comments:** Concur. Sikorsky refund proposal for an amount of \$219,371 is in review by the contracting officer and appropriate action will be taken as required.

(3) "Procure or have Sikorsky procure NSN 1615-01-221-2603 from DLA Aviation to save about \$1.3 million over the next two years based on planned contract quantities."

**Command Comments:** Concur. Quantities required for the remainder of the contract will be purchased through DLA as available as stated above in (b) (1) response.

(4) "Obtain refunds of about \$7.0 million from Sikorsky for unnecessary

pass-through costs and correct prices to avoid excessive profits of about \$10.4 million for NSNs 1615-01-390-0740, 1560-01-186-7122, 1560-01-125-9937, 1560-01-125-9938, and 1560-01-115-3667."

**Command Comments:** Partially concur: Nonconcur with obtaining refunds based on data outlined below, however, concur in reducing prices prior to exercise of 2012 requirements.

**NSN 1615-01-390-0740, Titanium Blade Sheath Assembly** - The DoDIG's evaluation that Sikorsky did not negotiate fair and reasonable prices or perform adequate cost or price analyses for the titanium blade sheath even though the unit price increased from \$7,936.57 in 2007 to \$17,004.39 in 2008 did not consider all the data utilized to price and negotiate this item. A review of Sikorsky's data indicates that cost price analysis was performed in accordance with FAR 15.404-3(b). That analysis for this item was based upon the multi-year 7 production contract (production and spares), which for [REDACTED] reflected 315 items for a total proposal value of [REDACTED]. Sikorsky conducted a cost price analysis [REDACTED]. Savings achieved through these types of negotiations are passed to the Government through both production and spares contracts. The cost price analysis, as well as [REDACTED] correspondence to its supplier, [REDACTED] contradicts the premise that there was no review of supplier costs below [REDACTED]. In November 2006, a letter from Sikorsky to [REDACTED] stated that Sikorsky would be assisting [REDACTED] in a fact-finding review of their proposal [REDACTED]. This data and review led to the long-term agreement [REDACTED].

Additionally, the DoDIG's conclusion that "the titanium blade sheath assembly is the top dollar item on the contract with average total procurements of about \$14M annually" is not totally accurate. The actual quantities sold from 2008 through June 2011 reflect an annual average of \$6.0M. Totals for specific quantities purchased for each year are reflected below:

2008 -	\$ 3,056,330.96
2009 -	\$12,060,419.80
2010 -	\$ 4,229,989.80
2011 -	\$ 4,800,854.41

The DoDIG's assertion "By entering into [REDACTED], Sikorsky ensured that it had no risk of loss due to significant changes in the price of the titanium and established predictable and increased profits over the course of the CCAD/Sikorsky contract due to the escalation clause in the prime contract" does not appear to be supported by the documentation in Sikorsky files. One fact that was not discussed in the audit is disclosed in the Memorandum of Agreement with Sikorsky [REDACTED] for the blade sheaths for the [REDACTED]. This agreement obligates Sikorsky to purchase a minimum of [REDACTED] of the blades in the forecast quantity in the year of delivery. Should Sikorsky fail to

purchase [REDACTED] of the forecasted quantity of blades in any year, they are required to immediately purchase the excess quantity of raw material (titanium). This fact places substantial cost risk on Sikorsky to closely monitor the usage quantities or purchase the excess material.

Additionally, the audit report indicates that the raw material supplier, [REDACTED], made a significant profit based on the reduction in the cost of titanium after contract award. In a firm-fixed price environment the risk is the contractor's for price increases as well as price decreases. In the case of the raw material supplier at the time of price agreement, the [REDACTED] pricing was comparable to a commodities market price, in which the contractor could have seen significant material price increases based on the market conditions. As stated in the audit, the prices for titanium ingot in 2006 – 2007 (at the time of pricing for this requirement) reflected significant increases. The fact that the raw material market saw reductions in price subsequent to award does not negate the overall value of firm-fixed pricing. Should the price of titanium continued to increase, in a fixed price contract, [REDACTED] would not have been able to increase his price to Sikorsky.

Sikorsky has developed a blade bonding fixture that has reduced the scrap rate for these blade sheath assemblies. In 2011 this has led to a reduction in the scrap rate for these by 51%. This represents a cost avoidance that is based on a reduction in the new purchase of blade sheaths due to the reduction in the scrap rate. Additionally, as a result of this effort, Sikorsky has ensured that CCAD is an organic source for repair of a heater mat associated with this item. Historically, Sikorsky was the only source of repair for this mat. With the organic capability at CCAD, Sikorsky has lost workload, but has helped expand the depot's capabilities and the industrial base.

**Items** - The DoDIG report identified items with [REDACTED], a subcontractor to Sikorsky, for which "Sikorsky officials did not negotiate fair and reasonable prices or perform adequate cost or price analysis to establish the reasonableness of the proposed prices for four items procured from [REDACTED], resulting in excessive pass-through charges." The items are identified as follows:

NSN 1560-01-186-7122 P/N 70500-02068-050  
NSN 1560-01-125-9938 P/N 70500-03050-058  
NSN 1560-01-125-9937 P/N 70500-03050-057  
NSN 1560-01-115-3667 P/N 70500-02063-059

Per the DoDIG report, "Sikorsky's cost or price analysis, completed in July 2007, was not adequate, merely recommended negotiation objectives from the [REDACTED] proposal, and did not address whether the proposed prices were fair and reasonable. From our review of prices for the four items, it appeared that Sikorsky accepted [REDACTED] prices as proposed and passed on the significant price increases to AMCOM."

A review of Sikorsky's data relative to these parts indicates that Sikorsky completed a cost price analysis (CPA) of [REDACTED] proposal. The CPA covered the spares portion only, which represented approximately [REDACTED]. The analysis

was completed on a total material, material escalation, labor hour and direct labor rate with Optimal and Maximum targets established for each category. No exception was taken to the proposed rates and factors after discussions with the Atlanta DCAA office. A position was ascertained on profit and Optimal and Maximum targets were established for each of the [REDACTED] parts, including the four items cited in the report. In total, the Optimal and Maximum targets were approximately [REDACTED] [REDACTED] [REDACTED] than proposal values respectively.

Changes to planned quantities of the [REDACTED] parts in the CPA raised the [REDACTED] proposal value from [REDACTED]. The [REDACTED] in spares was part of a larger [REDACTED] proposal for [REDACTED] for [REDACTED]. According to Sikorsky's Negotiation Summary for [REDACTED] dated 31 August 2007, the proposal was negotiated as a whole and price agreement of [REDACTED] was reached on 23 July 2007.

[REDACTED]

A comparison of the final negotiation amounts to the proposed amounts for the [REDACTED] and spare parts was included in the Sikorsky negotiation summary. Overall, this negotiation approach basically enabled Sikorsky to meet its combined CPA Optimal target for the entire [REDACTED] production and spares subcontract program.

Without reviewing the entire negotiation summary package for the [REDACTED] production and spare parts program, there is an appearance that Sikorsky accepted the spare parts as proposed, without negotiation as stated in the DoDIG report. However, the negotiation summary reflects that acceptance of the [REDACTED] spares prices as proposed, enabled Sikorsky to meet its optimum overall negotiation goal for the combined production and spares program and ultimately pass the savings to the Army.

Based on a review of these individual parts as presented in the CPA, the contracting officer will request that Sikorsky adjust the pricing to be more in line with the vendor pricing.

(5) "Consider using an economic price adjustment clause in the follow-on contract unless acceptable long-term prices for titanium can be negotiated."

**Command Comments:** Concur. Should titanium prices be in a state of significant fluctuation an economic price adjustment clause will be incorporated into the follow-on contract.

(6) "Request a refund of about \$3.3 million from Sikorsky and correct contract prices for 2011 and 2012 to avoid excessive profits totaling about \$4.2 million for which lower prices were negotiated with suppliers shortly after prices were negotiated with the Army."

**Command Comments:** Partially Concur. The DoDIG report identified 19 parts for potential refunds relative to negotiating lower prices after AMCOM contract was awarded. They identified three general categories: (1) Sikorsky negotiated a lower price with its supplier shortly after negotiating the contract price with AMCOM, (2) Sikorsky proposed the price to manufacture the item then procured the item directly from a supplier at a lower cost, or (3) Sikorsky negotiated a price with AMCOM using low quantities then purchased larger quantities at a lower price. It is noted that FAR Part 2.101 provides this definition - "*Cost or pricing data (10 U.S.C. 2306a (h) (1) and 41 U.S.C. 254b) means all facts that, as of the date of price agreement, or, if applicable, an earlier date agreed upon between the parties that is as close as practicable to the date of agreement on price, prudent buyers and sellers would reasonably expect to affect price negotiations significantly.*" The Government assumes that contractors' proposals are based on economic order quantities/buys. However, once evaluation/negotiations have concluded and the contractor's pricing is based upon accurate and complete data in accordance with his certification as stated above, the fact that he may negotiate lower prices with some vendors (in many instances cited by the DoDIG's report 6 – 14 months after award) the contractor has met the standard requirement for Cost and Pricing certification. This is a common industry practice of doing business, as adjustments are made from quotes to purchase orders using Government reviewed and approved accounting and material cost estimating systems. The material certification cost cutoff date for the bridge contract, W58RGZ-08-C-0037, was established as 8 April 2008. The follow-on contract reflected a material pricing certification cutoff date of 8 May 2008.

Each of the 19 items has been reviewed utilizing the data provided by Sikorsky relative to their pricing of each part as well as the data in the Government files. For the issues relative to make/buy issues cited by the report as indicating pricing issues, there are two items specifically discussed in the report as reflecting "pricing issues." However, a review was conducted of each make/buy item in the sample of 28. Based upon this review it was determined that Sikorsky has a disciplined process to review items categorized as make/buy decisions. All pertinent issues are considered, such as capacity, demand, and ensuring that a qualified vendor can support their production with a quality part at time of need. There is an established formal "gate" process. This make/buy determination is decided by a board established at the vice-president level and based upon a review of all data points as cited herein. Each of these issues is addressed below with some specific information provided for many of the items. For the four items specifically detailed in the audit, explanations are below. For the remaining 15, each was reviewed and summary explanations are provided by category.

(a) Sikorsky negotiated a lower price with its supplier shortly after negotiating the contract price with AMCOM

**Sample 330 - Flush Door Ring NSN 5340-01-101-4086** - Per the DoDIG report, "The 2009 contract price of \$273.52 was based on a long-term agreement Sikorsky had with its supplier at a unit price of [REDACTED]. The material cost certification cutoff date was April 8, 2008. After negotiation of the CCAD/Sikorsky contract price, Sikorsky negotiated and entered into a purchase order with a different supplier on June 13, 2009, to support requirements for the remainder of the contract at a [REDACTED] unit price (valid through June 2013)."



A review of Sikorsky's purchase order history for the flush door ring indicates that a long-term purchase agreement was in effect for deliveries through 2009 at a unit price of [REDACTED]. In addition, [REDACTED] were purchased under a separate purchase order with the same supplier at a unit price of [REDACTED] on 11 March 2008, less than one month prior to the material cost certification cutoff date. The purchase order history shows a purchase of [REDACTED] from a different new supplier on 12 June 2009. This purchase was about 14 months after the material cost certification cutoff date.

The price was established using an existing Long Term Agreement as the cost basis. There is no information in the purchase order history prior to the material cost certification cutoff date that Sikorsky had quotes from or established prices with a new supplier. However, AMCOM is working with DLA to determine their ability to support this requirement and if adequate quantities are available, this item will be removed from the contract for future requirements. If DLA cannot support this requirement Sikorsky will be requested to provide a reduced unit price in line with their reduced vendor price of [REDACTED].

**Make/Buy Issue - Sample 29 - Pinion NSN 3020-01-139-1321** - Per the DoDIG report, "Sikorsky proposed this item as a make item to establish the 2009 CCAD/Sikorsky contract price of \$5,839.88. After the contract proposal was certified, Sikorsky then negotiated a long-term agreement with [REDACTED], which reduced its costs to [REDACTED], which was valid from September 29, 2008, to December 31, 2012."

A review of Sikorsky's purchase order shows that there were no priced quotes received for the pinion prior to the material cost certification cutoff date. Purchase orders were placed for various quantities on 29 September 2008, almost six months after the material cost certification cutoff date.

The Sikorsky purchase order history and internal correspondence indicates that the decision to buy the pinion rather than manufacture it was not made until several months after price agreement was reached for the CCAD/Sikorsky contract. Sikorsky delivered some of these items in 2008, which were manufactured pending the approval of the vendor. The contracting officer will request that Sikorsky reduce the price to be more aligned with their vendor pricing for the remainder of the contract period.

**Make/Buy - Sample 12 - Center Housing Assembly NSN 3040-01-095-7220** - Per the DoDIG report, "After negotiations with AMCOM, Sikorsky began to procure the item directly from a supplier for a lower price. Specifically, Sikorsky proposed this item as a make part to establish the 2009 CCAD/Sikorsky contract price of \$12,066 each. However, Sikorsky began purchasing this item in September 2008 and locked in a price of [REDACTED] from its supplier through June 2012."

A review of Sikorsky's purchase order history shows that during the proposal evaluation, the most recent priced quotes for the housing were received months after the material cost certification cutoff date. Purchase orders were placed for various quantities on 17 September 2008, almost six months after the material cost certification cutoff date.



The purchase order history shows that in September 2004, orders were placed with a supplier, [REDACTED], under a general purchase agreement for the housings. A Sikorsky Executive Summary for approval of the Long Term Agreement (LTA) with [REDACTED] dated 22 September 2008 states "The 70351-08015-042 was a make part until July 2006 when Sikorsky qualified [REDACTED] as a supplier source. [REDACTED] This is an indication of the risk Sikorsky has in developing qualified sources and obtaining delivery of quality products on time as required. The summary further states "In consideration of the current business needs, the buyer feels he has effectively prepared a contract to secure supply that is fair and reasonable to both parties and recommends your approval."

Sikorsky's purchase order history and the summary their buyer wrote in September 2008 to obtain approval for the LTA with a new vendor indicates that the housing was a make item at the time of material cost certification cutoff date. The case documentation associated with the LTA clearly identifies Request for Quote, response and negotiation dates several months after the material cost certification cutoff date. Negotiations with the supplier occurred in September 2008. The documentation confirms that the decision to change the housing from a make to a buy was made after contract award and after careful and prudent consideration. The contracting officer will request Sikorsky reduce the price to be more representative of their vendor pricing for the remainder of the contract period.

**Sample 134 - Access Cover NSN 1560-01-173-5845 P/N 62656** – Per the DoDIG "Sikorsky negotiated prices with AMCOM using low quantities, then purchased larger quantities at a lower price but did not pass on the savings to the Army."

Per the DoDIG report, "Sikorsky's proposed price for this item was based on a quantity that was not representative of the annual contract demands. The negotiated contract price was based on a price [REDACTED] for a quantity of [REDACTED] when AMCOM planned to procure more than 350 annually. Sikorsky procured larger quantities at a much lower price [REDACTED] which inflated its profits for this item. Sikorsky's purchase history for this item ranged [REDACTED]"

**Response:** A review of Sikorsky's purchase order history for the Access Cover reflects single digit purchase and quote quantities in the four years preceding 2008. The most recent order at the time for a quantity [REDACTED] was agreed to as the basis of cost for the contract. The projected quantities for the CCAD contract for 2008 were six each and for 2009, four each. Years 2010 through 2012 projected larger quantities – 223 for 2010 and 437 for both 2011 and 2012. The order for [REDACTED] was not placed until 12 February 2009, about 10 months after the material cost certification cutoff date. The contract price was established using the most recent purchase as the cost basis. Total quantities purchased since 2008 are [REDACTED]. A review of DLA stock indicates a sufficient quantity to meet projected demands through 2012; therefore, DLA will be requested to support the remainder of this requirement.

**Sikorsky Negotiated Lower Price After Negotiations with AMCOM**

**Sample 8 Shaft Assembly NSN 3040014158388 – P/N 70351-08131-048** - On 26 February 2007 Sikorsky received a signed quotation from [REDACTED] for a Not-to Exceed

(NTE) unit price of [REDACTED] for the shaft assembly. On 13 February 2009, Sikorsky and [REDACTED] entered into a Memorandum of Agreement for [REDACTED] for 2010 at a firm fixed price [REDACTED]. The attachment to the Memorandum of Agreement contained an NTE letter contract for a quantity of [REDACTED] at an NTE unit price [REDACTED]. Sikorsky's termination liability for the letter contract was [REDACTED]. Order was definitized in May 2009.

As late as 13 February 2009, approximately 10 months after the material cutoff date, the NTE unit price [REDACTED] was the established value for the shaft assembly. Sikorsky has validated their payment to [REDACTED] for some assets shipped prior to definitization of the firm price, reflected payment of the NTE price [REDACTED]. The firm negotiated unit price was not established until 12 May 2009. On 12 May, 2009, Sikorsky issued an order to [REDACTED] to manufacture 70351-08131-048 Main Rotor Shaft Assemblies at a unit price of [REDACTED] using Sikorsky supplied 70351-08131-108 Main Rotor Shafts. The value of the -108 Shaft was added to the -048 Assembly manufacturing price of [REDACTED] for a proper comparison. Sikorsky current pricing history for the -108 shaft shows a 20 November 2009 quote for [REDACTED]. However, the history also shows large quantities of -108 shafts purchased in the 2003 timeframe at unit prices of [REDACTED]. With the addition of the cost of these shafts, the cost basis for these reflected a range [REDACTED]. Sikorsky obtained cost and pricing data from [REDACTED] for the pricing. Prior to definitization at a lower unit price, 85 items were shipped under the contract to CCAD reflecting a total amount of [REDACTED]. Based upon the IG calculation of unit price for 2010, the contracting officer will request Sikorsky reduce their unit price to be more in line with this calculation [REDACTED] and/or their negotiated vendor pricing for the remainder contract period.

**Sample 66 Pin NSN 5320014560634, P/N HL204-6-7**

A review of Sikorsky's data reflects that on 8 March 2007 Sikorsky confirmed a [REDACTED]  
[REDACTED]  
[REDACTED] This order is dated approximately nine months after the material cost cutoff date for the contract pricing. The purchase history shows that the reduced pricing is directly related to significant increases in purchase quantities that were not initially available to the contractor until after award of the contract. Currently there are no projected quantities on the contract for 2011 and 2012; however, should a need arise DLA will be contacted to determine if they can meet the requirement. Currently DLA has stock on hand to support the requirement. There is no current contractual basis upon which to obtain a refund for the items already shipped under the contract.

**Sample 109 PIN NSN 5320014561475, P/N HL204-6-6**

The contract unit price for this item was established using a unit price of [REDACTED] based on a long-term agreement with [REDACTED] dated 5 May 2006. On 24 February

2009, more than 10 months after the material cost cutoff date, an order for a quantity of [REDACTED] was placed with another supplier at a unit price of [REDACTED]. On 4 May 2009, Sikorsky placed an order for a quantity of [REDACTED].

The contract negotiated unit price was based on existing supplier pricing at the time of the material cost cutoff date. The low price of [REDACTED] appears to be a one-time buy with that specific supplier. Sikorsky currently states they cannot provide the background data as to why this was a one-time buy. It is assumed that there was a problem with the supplier, but it is not documented in their records. A total quantity of 1,584 items has been purchased under this contract for a total dollar value of \$20,523.84. Currently there are no projected quantities on the contract for 2011 and 2012; however, should a need arise DLA will be contacted to determine if they can meet the requirement. There is no current contractual basis upon which to obtain a refund for the items already shipped under the contract.

**Sample 113 Bearing Assembly NSN 3120010906519, P/N 70209-07901-102**

The contract unit price for this item was established using a unit price of [REDACTED] based on a long-term agreement with [REDACTED], dated 4 December 2007. On 28 July 2008, more than three months after the material cost cutoff date, an order for a [REDACTED] was placed with another supplier number at a unit price of [REDACTED]. Subsequent quotes received in August 2010 from the original supplier [REDACTED] are at a unit price of [REDACTED].

The contract unit price was based on existing supplier pricing at the time of the material cost cutoff date. The contractor's files do not show why the one time buy for [REDACTED] was made with a supplier other than [REDACTED] or why that supplier did not quote for subsequent purchases. Based upon this information, the contract price reflects the data in Sikorsky's file. 789 items have been provided under the contract to date, reflecting a total value of \$602,274.43. An estimated quantity of 350 is projected for 2011 and 2012 and a quantity of 145 has already been provided in 2011. The contracting officer will request Sikorsky to adjust their pricing to be in line with their supplier pricing.

**Sample 175 - Bracket NSN 1615011026051, P/N 70101-11103-102**

Sikorsky's purchase history for the bracket shows a 2004 unit price of [REDACTED] with a supplier as the basis of cost for the contract. In December 2008, nine months after the material cost cutoff date, the contractor was able to obtain a [REDACTED] unit price from the same supplier when purchasing a combined quantity of [REDACTED].

The contract unit price was based on existing supplier pricing at the time of the material cost cutoff date. The contractor was able to reduce the unit price [REDACTED] when the purchased quantities increased [REDACTED]. A total quantity of 2,809 has been purchased by CCAD to date, reflecting a total value of \$456,786, unit prices ranging from \$99 to \$112 from 2008 through 2012. This quantity is significantly less than estimated in the contract total projected quantities of 7,081. However, there is no firm minimum quantity for any item in the contract, only estimated quantities, which

places the risk on Sikorsky for pricing and issuing orders to their suppliers. The contracting office will request that Sikorsky revise their pricing to reflect prices more in line with their current vendor costs.

**Sample 255 Bellcrank Assembly NSN 1680012737591, P/N 70400-02209-046**

The Bellcrank Assembly is one of the items that had a large discrepancy in unit pricing based on Sikorsky's purchase history. After disclosure of the 2006 purchase unit price [REDACTED] for supplier number [REDACTED] and the 2008 purchase unit price of [REDACTED] for supplier number [REDACTED], Sikorsky and DCMA agreed to include this item as one of the 304 parts on the Interim Priced Item list, Exhibit C to the contract. According to clause H-18, revised interim unit prices will be adjusted to reflect the final negotiated fully burdened prices for these items via a subsequent contract modification. A final negotiated price has not yet been determined for this item; however, it will reflect the current supplier pricing and will provide economic order quantity pricing. This is estimated to be complete by 31 July 2011.

**[REDACTED] Items**

Five of the items, identified by the IG audit as Sikorsky obtaining lower prices after AMCOM negotiations, are [REDACTED] parts, which are supplied through Derco (a Sikorsky subsidiary). As previously stated in this response, [REDACTED] is always concerned that orders to be proposed to CCAD are at significant risk of cancellation (based on their past experience with these). The [REDACTED] items are proposed through Derco as commercial items. For many items, [REDACTED] does not negotiate below the proposed prices. Based upon this issue, AMCOM Contracting Officer will request that [REDACTED] work with Sikorsky to reduce the prices for the following items for the remainder of the contract period.

**Sample 104 - Stator Housing Assembly, NSN 6115011177281, P/N 1588505-1**

The contract unit price was based on a firm quote received from [REDACTED] [REDACTED] dated 26 April 2007. The quote was for a quantity [REDACTED]. According to Sikorsky's purchase order history, a quote for a quantity of [REDACTED] housings at a unit price [REDACTED] was received from [REDACTED] on 5 Feb 2009, nearly 10 months after the material cost cutoff date. Subsequent orders were issued to [REDACTED] at the unit price of [REDACTED]. This is a low demand item and to date only 20 items have been provided to CCAD, reflecting a total value of \$188,199.80. The projection for the remainder of 2011 is six each and for 2012 it is 11 each. The Contracting officer will negotiate a price reduction for the remainder of the contract;

**Sample 156 - Rotor Generator NSN 6115011177238, P/N 1588541-1**

Derco (a Sikorsky subsidiary) accepted the [REDACTED] commercial unit prices for years 2008 through 2012. In addition, Derco was able to negotiate a lower unit price of [REDACTED] with [REDACTED] for 2008 only. This savings was passed along to the Army via a lower Material Unit Cost for 2008 reflected in the contract unit price for 2008 of \$8,814.39. However, for 2009 – 2012 the unit prices from [REDACTED] reflect a range from \$9,446 up to \$11,572. Total quantity purchased from 2008 – 2011 is 22 each for a total value of \$258,852.56. Small quantities of this item have been purchased since 2008, no additional quantities are projected for the remainder of 2011, and there is a projection for 12 each in 2012.

**Sample 285 Printed Circuit Board NSN 5998011451798, P/N 61-2020-1**

Derco (a Sikorsky subsidiary) accepted the [REDACTED] commercial unit prices for years 2008 through 2012. Total quantity purchased is 57 each for a total of \$330,018.00, reflecting a unit price range from \$5,242 to \$6,001. Contract reflects an estimated quantity of 12 each for 2011 and CCAD has purchased 29. For 2012 the contract projects a quantity of 12; however, the quantity increase in 2011 is indicative of the dynamic requirements reflected in the depot process.

(7) "Request a voluntary refund of about \$5.4 million from Sikorsky for profits caused by excessive escalation from 2008 through 2010."

**Command Comments:** Partially Concur. During the proposal evaluation, Sikorsky provided information that reflected a review of the 4<sup>th</sup> Quarter 2007 Global Insight Producer Price Index for Aircraft and Parts for the period 2005 – 2007. This reflected an average escalation of 3.9% and a forecast of 3.1% for 2008 and 1.8% for 2009. Sikorsky shared with the negotiation team, that their estimation was that the forecasted values were heavily based on an anticipated significant reduction in energy prices in 2008 from the \$75 per barrel of oil used in the 2007 forecast. During the first quarter of 2008, energy prices actually increased by 33% as oil exceeded \$100 per barrel. In the response, [REDACTED]

[REDACTED]

A review of Sikorsky's actual escalation on subcontract proposals was conducted on purchases that were made in each of the three years from 2008, 2009, and 2010. This

resulted in 3,213 "common" items (i.e. actually purchased in all three years). A sum of the total unit costs incurred for each of the 3,213 common items was compared to the yearly totals from year to year. The subcontract escalation from 2008 to 2009 was [REDACTED] and from 2009 to 2010 was [REDACTED]

The Government contracting officer negotiated this escalation factor based on the conditions of the market known at the time, which as indicated above, was judged to exceed some of the indices projections. The market forces at play in 2008, which projected increases in energy prices as well as the Sikorsky [REDACTED], indicated that 4% escalation was in line at the time. Additionally, a review of [REDACTED] incurred indicates an approximate 4% escalation. Based upon the data reviewed by the contracting officer at the point of negotiations in 2008, it is concluded that proper consideration was taken by the buying office to substantiate that the resulting escalation factor was reasonable for the out years for the labor and material estimated.

For the 2012 prices, negotiations will be conducted with Sikorsky to achieve a reduced escalation based on the current market conditions. The 2012 prices will be adjusted to reflect this reduction.

(8) "Account for and request a refund for Sikorsky for excessive escalation for 2011."

**Command Comments:** Partially Concur. The contract will be reviewed to assess escalation projections for the remaining period of performance of the contract.

(9) "Modify the contract to base contract escalation on an appropriate economic index and correct prices to avoid excessive prices of \$8.7 million in 2012, before exercising the next option year."

**Command Comments:** Concur. For the 2012 prices, negotiations will be conducted with Sikorsky to achieve a reduced escalation based on the current market conditions. The 2012 prices will be adjusted to reflect this reduction.

(10) "Perform cost analysis and adjust pricing of a limited sample of high-risk, high-dollar items before exercising the next option or pursue a fixed-price incentive contract."

**Command Comments:** Concur. A sample of high-risk, high-dollar items will be reviewed via cost analysis prior to exercise of the next option. This will also consider price reasonableness, escalation, index applicability, capacity requirements, make or buy decisions, and DLA availability of items.

**General Comments:** AMCOM and ACC-RSA concur in obtaining contractual refunds or demanding price reductions on any items in which the contractor did not provide full disclosure of data, obvious errors were made by either the contractor or the

Government, or the contractor was substantially negligent in establishing reasonable prices with a supplier. However, in any fixed price arrangement where you are procuring material of this magnitude, there will be parts negotiated after the fact that are lower in cost and parts that increase in price. The key is whether the overall price and/or quantity changes are substantial enough to warrant a change in either procedures or contract type.

Since this was a performance-based agreement requiring the contractor to bring the necessary material to the depot as needed to support production, a business case analysis was performed prior to execution of the contract. It was expected that material would increase by approximately 25% due to procuring through a prime contractor at lower quantities and requiring rapid turn times. To date, on the average material price increases are as follows when compared to historical DLA and AMDF prices:

Year	DLA	AMDF
2009	10% increase	3% increase
2010	16% increase	9% increase
2011	21% increase	14% increase

Some of the benefits received include a 33 percent reduction in repair turn around time which led to an increase in overall production and increase in readiness for the Blackhawk platform. Based on the overall comparison the overall transaction continues to meet the parameters set forth in the Business Case Analysis. Nevertheless, experience over the past several years with these contracts, new visibility of inventory across DoD and improvements in the overall supply base within DLA and AMCOM offer the opportunity to drive improvements in the process, create efficiencies and mitigate issues such as those identified in this report. Some steps planned for future partnerships include a more comprehensive partnership with DLA to require procurement of their inventory, where available, sampling of high dollar prices annually prior to exercise of options, reduction of pass-through costs on material procured through DLA and/or material incentives that allow for sharing of substantial savings due to vendor cost reductions.

# Defense Contract Management Agency Comments



DEFENSE CONTRACT MANAGEMENT AGENCY  
6350 WALKER LANE, SUITE 300  
ALEXANDRIA, VIRGINIA 22310-3241

June 28, 2011

DCMA-AQ

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE  
DIRECTOR OF PRICING AND LOGISTICS ACQUISITION,  
ACQUISITION AND CONTRACT MANAGEMENT

SUBJECT: Response to FOUO Draft Department of Defense Office of Inspector General  
(DoDIG) Audit Report "Pricing and Escalation Issues Weaken the Effectiveness of  
the Army Contract With Sikorsky to Support the Corpus Christi Army Depot" dated  
June 2, 2011, Project No. D2010-D000CH-0077.001

We have attached the Headquarters, Defense Contract Management Agency's comments  
to the recommendations as requested in the subject draft report.

Point of contact for this audit is



Attachment

A handwritten signature in cursive script, reading "Timothy P. Callahan", is positioned above the printed name.

TIMOTHY P. CALLAHAN  
Executive Director  
Contracts

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DCMA Response to FOUO Draft DoDIG Audit Report "Pricing and Escalation Issues Weaken the Effectiveness of the Army Contract With Sikorsky to Support the Corpus Christi Army Depot" dated June 2, 2011

DCMA provides the following comments to the draft report:

RECOMMENDATION 1: We recommend that the Director, Defense Contract Management Agency, instruct the Contractor Purchasing System Division Director to identify the purchasing system at Sikorsky, Stratford, Connecticut, as high risk and schedule a purchasing system review to determine whether Sikorsky conducts subcontractor price and cost analyses before prime contract negotiations and whether quantity discounts are being adequately passed on to the Government.

Response: Concur with recommendation. DCMA conducted a Contractor Purchasing System Review (CPSR) at Sikorsky in January 2011. Deficiencies were noted, including one in the price analysis area. Sikorsky's Purchasing Systems has been identified as high risk. A CPSR has been scheduled for February 2012 to verify and validate the effectiveness of corrective actions currently being implemented by Sikorsky. Our review will include, among other key CPSR elements, the timing of subcontractor price analysis and whether discounts are passed along to the government.





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Inspector General  
Department *of* Defense

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